

INTERMEDIATE (IPC) COURSE

STUDY MATERIAL

PAPER : 4

TAXATION

Part – 1 : Income-tax

Assessment Year 2015-16

[As amended by the Finance (No.2) Act, 2014]

MODULE – 2



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4

Heads of Income

UNIT-1 : INCOME FROM SALARIES

Learning objectives

After reading this unit, you will be able to understand:

- ◆ when the salary income is chargeable to tax
- ◆ the concept of profits in lieu of salary
- ◆ the various retirement benefits which will be charged as salary
- ◆ the concepts of allowances and perquisites
- ◆ the admissible deductions from salary

1.1 Salary

The meaning of the term 'salary' for purposes of income tax is much wider than what is normally understood. Every payment made by an employer to his employee for service rendered would be chargeable to tax as income from salaries. The term 'salary' for the purposes of Income-tax Act, 1961 will include both monetary payments (e.g. basic salary, bonus, commission, allowances etc.) as well as non-monetary facilities (e.g. housing accommodation, medical facility, interest free loans etc).

(1) Employer-employee relationship: Before an income can become chargeable under the head 'salaries', it is vital that there should exist between the payer and the payee, the relationship of an employer and an employee. Consider the following examples:

- (a) Sujatha, an actress, is employed in Chopra Films, where she is paid a monthly remuneration of ₹ 2 lakh. She acts in various films produced by various producers. The remuneration for acting in such films is directly paid to Chopra Films by the different producers. In this case, ₹ 2 lakh will constitute salary in the hands of Sujatha, since the relationship of employer and employee exists between Chopra Films and Sujatha.
- (b) In the above example, if Sujatha acts in various films and gets fees from different producers, the same income will be chargeable as income from profession since the relationship of employer and employee does not exist between Sujatha and the film producers.

- (c) Commission received by a Director from a company is salary if the Director is an employee of the company. If, however, the Director is not an employee of the company, the said commission cannot be charged as salary but has to be charged either as income from business or as income from other sources depending upon the facts.
- (d) Salary paid to a partner by a firm is nothing but an appropriation of profits. Any salary, bonus, commission or remuneration by whatever name called due to or received by partner of a firm shall not be regarded as salary. The same is to be charged as income from profits and gains of business or profession. This is primarily because the relationship between the firm and its partners is not that of an employer and employee.

(2) **Full-time or part-time employment:** It does not matter whether the employee is a full-time employee or a part-time one. Once the relationship of employer and employee exists, the income is to be charged under the head "salaries". If, for example, an employee works with more than one employer, salaries received from all the employers should be clubbed and brought to charge for the relevant previous years.

(3) **Foregoing of salary:** Once salary accrues, the subsequent waiver by the employee does not absolve him from liability to income-tax. Such waiver is only an application and hence, chargeable to tax.

Example: Mr. A, an employee instructs his employer that he is not interested in receiving the salary for April 2014 and the same might be donated to a charitable institution. In this case, Mr. A cannot claim that he cannot be charged in respect of the salary for April 2014. It is only due to his instruction that the donation was made to a charitable institution by his employer. It is only an application of income. Hence, the salary for the month of April 2014 will be taxable in the hands of Mr. A. He is however, entitled to claim a deduction under section 80G for the amount donated to the institution. [The concept of deductions is explained in detail in Chapter 7].

(4) **Surrender of salary:** However, if an employee surrenders his salary to the Central Government under section 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered would be exempt while computing his taxable income.

(5) **Salary paid tax-free:** This, in other words, means that the employer bears the burden of the tax on the salary of the employee. In such a case, the income from salaries in the hands of the employee will consist of his salary income and also the tax on this salary paid by the employer.

1.2 Definition of Salary

The term 'salary' has been defined differently for different purposes in the Act. The definition as to what constitutes salary is very wide. As already discussed earlier, it is an inclusive definition and includes monetary as well as non-monetary items. There are different definitions of 'salary' say for calculating exemption in respect of gratuity, house rent allowance etc.

'Salary' under section 17(1), includes the following:

- (i) wages,

- (ii) any annuity or pension,
- (iii) any gratuity,
- (iv) any fees, commission, perquisite or profits in lieu of or in addition to any salary or wages,
- (v) any advance of salary,
- (vi) any payment received in respect of any period of leave not availed by him i.e. leave salary or leave encashment,
- (vii) the portion of the annual accretion in any previous year to the balance at the credit of an employee participating in a recognised provident fund to the extent it is taxable and
- (viii) transferred balance in recognized provident fund to the extent it is taxable,
- (ix) the contribution made by the Central Government or any other employer in the previous year to the account of an employee under a pension scheme referred to in section 80CCD.

1.3 Basis of charge

1. Section 15 deals with the basis of charge. Salary is chargeable to tax either on 'due' basis or on 'receipt' basis, whichever is earlier.
2. However, where any salary, paid in advance, is assessed in the year of payment, it cannot be subsequently brought to tax in the year in which it becomes due.
3. If the salary paid in arrears has already been assessed on due basis, the same cannot be taxed again when it is paid.

Examples:

- i. If A draws his salary in advance for the month of April 2015 in the month of March 2015 itself, the same becomes chargeable on **receipt basis** and is to be assessed as income of the P.Y.2014-15 i.e., A.Y.2015-16. However, the salary for the A.Y.2016-17 will not include that of April 2015.
- ii. If the salary due for March 2015 is received by A later in the month of April 2015, it is still chargeable as income of the P.Y.2014-15 i.e. A.Y.2015-16 on **due basis**. Obviously, salary for the A.Y.2016-17 will not include that of March 2015.

1.4 Place of accrual of salary

Under section 9(1)(ii), salary earned in India is deemed to accrue or arise in India even if it is paid outside India or it is paid or payable after the contract of employment in India comes to an end.

Example: If an employee gets pension paid abroad in respect of services rendered in India, the same will be deemed to accrue in India. Similarly, leave salary paid abroad in respect of leave earned in India is deemed to accrue or arise in India.

Suppose, for example, A, a citizen of India is posted in the United States as our Ambassador. Obviously, he renders his services outside India. He also receives his salary outside India. He is also a non-resident. The question, therefore, arises whether he can claim exemption in respect of his salary paid by the Government of India to him outside India. Under general principles of income tax such salary cannot be charged in his hands. For this purpose, section 9(1)(iii) provides that salaries payable by the Government to a citizen of India for services outside India shall be deemed to accrue or arise in India. However, by virtue of section 10(7), any allowance or perquisites paid or allowed outside India by the Government to a citizen of India for rendering services outside India will be fully exempt.

1.5 Profits in lieu of salary [Section 17(3)]

It includes the following:

- (i) The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment.
- (ii) The amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the modification of the terms and conditions of employment. Usually, such compensation is treated as a capital receipt. However, by virtue of this provision, the same is treated as a revenue receipt and is chargeable as salary.

Note: It is to be noted that merely because a payment is made by an employer to a person who is his employee does not automatically fall within the scope of the above provisions. The payment must be arising due to master-servant relationship between the payer and the payee. If it is not on that account, but due to considerations totally unconnected with employment, such payment is not profit in lieu of salary.

Example: A was an employee in a company in Pakistan. At the time of partition, he migrated to India. He suffered loss of personal movable property in Pakistan due to partition. He applied to his employer for compensating him for such loss. Certain payments were given to him as compensation. It was held that such payments should not be taxed as 'profit in lieu of salary' - *Lachman Dass Vs. CIT [1980] 124 ITR 706 (Delhi)*.

- (iii) Any payment due to or received by an assessee from his employer or former employer from a provident or other fund, to the extent to which it does not consist of employee's contributions or interest on such contributions.

Example: If any sum is paid to an employee from an unrecognised provident fund it is to be dealt with as follows :

- (a) that part of the sum which represents the employer's contribution to the fund and interest thereon is taxable under salaries.
- (b) that part of the sum which represents employee's contribution and interest thereon is not chargeable to tax since the same have already been taxed under the head 'salaries' and 'other sources' respectively on an yearly basis.

Note: It does not include exempt payments from superannuation fund, gratuity, commuted pension, retrenchment compensation, HRA.

- (iv) Any sum received by an assessee under a Keyman Insurance policy including the sum allocated by way of bonus on such policy.
- (v) Any amount, whether in lumpsum or otherwise, due to the assessee or received by him, from any person -
 - (a) before joining employment with that person, or
 - (b) after cessation of his employment with that person.
- (vi) Any other sum received by the employee from the employer.

1.6 Advance Salary

Advance salary is taxable when it is received by the employee irrespective of the fact whether it is due or not. It may so happen that when advance salary is included and charged in a particular previous year, the rate of tax at which the employee is assessed may be higher than the normal rate of tax to which he would have been assessed. Section 89(1) provides for relief in these types of cases. The concept of relief under section 89(1) is explained in para 1.23 of this Chapter.

1.7 Loan or Advance against salary

Loan is different from salary. When an employee takes a loan from his employer, which is repayable in certain specified installments, the loan amount cannot be brought to tax as salary of the employee.

Similarly, advance against salary is different from advance salary. It is an advance taken by the employee from his employer. This advance is generally adjusted with his salary over a specified time period. It cannot be taxed as salary.

1.8 Arrears of salary

Normally speaking, salary arrears must be charged on due basis. However, there are circumstances when it may not be possible to bring the same to charge on due basis. For example if the Pay Commission is appointed by the Central Government and it recommends revision of salaries of employees, the arrears received in that connection will be charged on receipt basis. Here, also relief under section 89(1) is available.

1.9 Annuity

1. As per the definition, 'annuity' is treated as salary. Annuity is a sum payable in respect of a particular year. It is a yearly grant. If a person invests some money entitling him to series of equal annual sums, such annual sums are annuities in the hands of the investor.

2. Annuity received by a present employer is to be taxed as salary. It does not matter whether it is paid in pursuance of a contractual obligation or voluntarily.
3. Annuity received from a past employer is taxable as profit in lieu of salary.
4. Annuity received from person other than an employer is taxable as "income from other sources".

1.10 Gratuity [Section 10(10)]

Gratuity is a voluntary payment made by an employer in appreciation of services rendered by the employee. Now-a-days gratuity has become a normal payment applicable to all employees. In fact, Payment of Gratuity Act, 1972 is a statutory recognition of the concept of gratuity. Almost all employers enter into an agreement with employees to pay gratuity. For details refer to Chapter 3.

1.11 Pension

Concise Oxford Dictionary defines 'pension' as a periodic payment made especially by Government or a company or other employers to the employee in consideration of past service payable after his retirement.

Commuted pension: Commutation means inter-change. Many persons convert their future right to receive pension into a lumpsum amount receivable immediately. For example, suppose a person is entitled to receive a pension of say ₹ 2000 p.m. for the rest of his life. He may commute $\frac{1}{4}$ th i.e., 25% of this amount and get a lumpsum of say ₹ 30,000. After commutation, his pension will now be the balance 75% of ₹ 2,000 p.m. = ₹ 1,500 p.m.

For details refer to Chapter 3.

1.12 Leave Salary [Section 10(10AA)]

For details refer to Chapter 3.

1.13 Retrenchment Compensation [Section 10(10B)]

For details refer to Chapter 3.

1.14 Compensation received on Voluntary Retirement [Section 10(10C)]

Any compensation received by an employee of a public sector company or of any other company or other specified bodies at the time of his voluntary retirement or termination of his service is exempt upto a maximum limit of ₹ 5,00,000. However, such payment should be in accordance with a scheme of voluntary retirement or in the case of a public sector company, a scheme of voluntary separation. Such schemes should be in accordance with prescribed guidelines. These guidelines may include economic viability as one of the criteria.

For details refer to Chapter 3.

1.15 Provident Fund

Provident fund scheme is a scheme intended to give substantial benefits to an employee at the time of his retirement. Under this scheme, a specified sum is deducted from the salary of the employee as his contribution towards the fund. The employer also generally contributes the same amount out of his pocket, to the fund. The contribution of the employer and the employee are invested in approved securities. Interest earned thereon is also credited to the account of the employee. Thus, the credit balance in a provident fund account of an employee consists of the following:

- (i) employee's contribution
- (ii) interest on employee's contribution
- (iii) employer's contribution
- (iv) interest on employer's contribution.

The accumulated balance is paid to the employee at the time of his retirement or resignation. In the case of death of the employee, the same is paid to his legal heirs.

The provident fund represents an important source of small savings available to the Government. Hence, the Income-tax Act, 1961 gives certain deductions on savings in a provident fund account.

There are four types of provident funds:

- (i) Statutory Provident Fund (SPF)
- (ii) Recognised Provident Fund (RPF)
- (iii) Unrecognised Provident Fund (URPF)
- (iv) Public Provident Fund (PPF)

The tax treatment is given below:

Particulars	Recognized PF	Unrecognized PF	Statutory PF	Public PF
Employer's Contribution	Amount in excess of 12% of salary is taxable	Not taxable yearly	Fully exempt	N.A. (as there is only assessee's own contribution)
Employee's Contribution	Eligible for deduction u/s 80C	Not eligible for deduction	Eligible for deduction u/s 80C	Eligible for deduction u/s 80C
Interest Credited	Amount in excess of 9.5% p.a. is taxable	Not taxable yearly	Fully exempt	Fully exempt
Amount received on retirement, etc.	See Note (1)	See Note (3)	Fully exempt u/s 10(11)	Fully exempt u/s 10(11)

Notes:

- (1) Amount received on the maturity of RPF is fully exempt in case of an employee who has rendered continuous service for a period of 5 years or more. In case the maturity of RPF takes place within 5 years then the amount received would be fully exempt only if the service had been terminated due to employee's ill-health or discontinuance or contraction of employer's business or other reason beyond control of the employee. In any other case, the amount received will be taxable in the same manner as that of an URPF.
 - (2) If, after termination of his employment with one employer, the employee obtains employment under another employer, then, only so much of the accumulated balance in his provident fund account will be exempt which is transferred to his individual account in a recognised provident fund maintained by the new employer. In such a case, for exemption of payment of accumulated balance by the new employer, the period of service with the former employer shall also be taken into account for computing the period of five years' continuous service.
 - (3) Employee's contribution is not taxable but interest thereon is taxable under 'Income from Other Sources'. Employer's contribution and interest thereon is taxed as Salary.
 - (4) Salary for this purpose means basic salary and dearness allowance - if provided in the terms of employment for retirement benefits and commission as a percentage of turnover.
- (1) **Statutory Provident Fund (SPF):** The SPF is governed by Provident Funds Act, 1925. It applies to employees of government, railways, semi-government institutions, local bodies, universities and all recognised educational institutions.
- (2) **Recognised Provident Fund (RPF):** Recognised provident fund means a provident fund recognised by the Commissioner of Income-tax for the purposes of income-tax. It is governed by Part A of Schedule IV to the Income-tax Act, 1961. This schedule contains various rules regarding the following:
- (a) Recognition of the fund
 - (b) Employee's and employer's contribution to the fund
 - (c) Treatment of accumulated balance etc.
- A fund constituted under the Employees's Provident Fund and Miscellaneous Provisions Act, 1952 will also be a Recognised Provident Fund.
- (3) **Unrecognised Provident Fund (URPF):** A fund not recognised by the Commissioner of Income-tax is Unrecognised Provident Fund.
- (4) **Public Provident Fund (PPF):** Public provident fund is operated under the Public Provident Fund Act, 1968. A membership of the fund is open to every individual though it is ideally suited to self-employed people. A salaried employee may also contribute to PPF in addition to the fund operated by his employer. An individual may contribute to the fund on his own behalf as also on behalf of a minor of whom he is the guardian.

For getting a deduction under section 80C, a member is required to contribute to the PPF a minimum of ₹ 500 in a year. The maximum amount that may qualify for deduction on this account is ₹ 1,50,000 as per PPF rules.

A member of PPF may deposit his contribution in as many installments in multiples of ₹ 500 as is convenient to him. The sums contributed to PPF earn interest at 8.7%. The amount of contribution may be paid at any of the offices or branch offices of the State Bank of India or its subsidiaries and specified branches of banks or any Post Office.

Illustration 1

Mr. A retires from service on December 31, 2014, after 25 years of service. Following are the particulars of his income/investments for the previous year 2014-15:

Particulars	₹
Basic pay @ ₹ 16,000 per month for 9 months	1,44,000
Dearness pay (50% forms part of the retirement benefits) ₹ 8,000 per month for 9 months	72,000
Lumpsum payment received from the Unrecognised Provident Fund	6,00,000
Deposits in the PPF account	40,000

Out of the amount received from the unrecognized provident fund, the employer's share was ₹ 2,20,000 and the interest thereon ₹ 50,000. The employee's share was ₹ 2,70,000 and the interest thereon ₹ 60,000. What is the taxable portion of the amount received from the unrecognized provident fund in the hands of Mr. A for the assessment year 2015-16?

Solution

Taxable portion of the amount received from the URPF in the hands of Mr. A for the A.Y. 2015-16 is computed hereunder:

Particulars	₹
Amount taxable under the head "Salaries":	
Employer's share in the payment received from the URPF	2,20,000
Interest on the employer's share	<u>50,000</u>
Total	2,70,000
Amount taxable under the head "Income from Other Sources" :	
Interest on the employee's share	<u>60,000</u>
Total amount taxable from the amount received from the fund	<u>3,30,000</u>

Note: Since the employee is not eligible for deduction under section 80C for contribution to URPF at the time of such contribution, the employee's share received from the URPF is not taxable at the time of withdrawal as this amount has already been taxed as his salary income.

4.10 Income-tax

Illustration 2

Will your answer be any different if the fund mentioned above was a recognised provident fund?

Solution

Since the fund is a recognised one, and the maturity is taking place after a service of 25 years, the entire amount received on the maturity of the RPF will be fully exempt from tax.

Illustration 3

Mr. B is working in XYZ Ltd. and has given the details of his income for the P.Y. 2014-15. You are required to compute his gross salary from the details given below:

Basic Salary	₹ 10,000 p.m.
D.A. (50% is for retirement benefits)	₹ 8,000 p.m.
Commission as a percentage of turnover	1%
Turnover during the year	₹ 5,00,000
Bonus	₹ 40,000
Gratuity	₹ 25,000
His own contribution in the RPF	₹ 20,000
Employer's contribution to RPF	20% of his basic salary
Interest accrued in the RPF @ 13% p.a.	₹ 13,000

Solution

Computation of Gross Salary of Mr. B for the A.Y.2015-16

Particulars	₹	₹
Basic Salary [₹ 10,000 × 12]		1,20,000
Dearness Allowance [₹ 8,000 × 12]		96,000
Commission on turnover [1% × ₹ 5,00,000]		5,000
Bonus		40,000
Gratuity [Note 1]		25,000
Employee's contribution to RPF [Note 2]		-
Employers contribution to RPF [20% of ₹ 1,20,000]	24,000	
Less : Exempt [Note 3]	20,760	3,240
Interest accrued in the RPF @ 13% p.a.	13,000	
Less : Exempt @ 9.5% p.a.	9,500	3,500
Gross Salary		2,92,740

Note 1 : Gratuity received during service is fully taxable.

Note 2 : Employee's contribution to RPF is not taxable. It is eligible for deduction under section 80C.

Note 3 : Employers contribution in the RPF is exempt up to 12% of the salary.

i.e. 12% of [Basic Salary + Dearness Allowance forming part of retirement benefits + Commission based on turnover]

= 12% of [₹ 1,20,000 + (50% × ₹ 96,000) + ₹ 5,000] = 12% of ₹ 1,73,000 = ₹ 20,760

1.16 Approved Superannuation Fund

It means a superannuation fund which has been and continues to be approved by the Commissioner in accordance with the rules contained in Part B of the VIth Schedule to the Income-tax Act, 1961.

The tax treatment of contribution and exemption of payment from tax are as follows:

- (i) Employer's contribution is exempt from tax in the hands of employee (upto ₹ 1,00,000 per employee per annum). Only such contribution exceeding ₹ 1,00,000 is taxable in the hands of the respective employee;
- (ii) Employee's contribution qualifies for deduction under section 80C;
- (iii) Interest on accumulated balance is exempt from tax.

Section 10(13) grants exemption in respect of payment from the fund—

- (a) to the legal heirs on the death of beneficiary (e.g. payment to widow of the beneficiary) or
- (b) to an employee in lieu of or in commutation of an annuity on his retirement at or after the specified age or on his becoming incapacitated prior to such retirement, or
- (c) by way of refund of contribution on the death of the beneficiary or,
- (d) by way of refund of contribution to an employee on his leaving the service in connection with which the fund is established otherwise than in the circumstances mentioned in (b), to the extent to which such payment does not exceed the contribution made prior to April 1, 1962. For example, where the amount received by an employee does not include any contribution made prior to 1.4.1962, the whole amount is taxable.

1.17 Salary from United Nations Organisation

Section 2 of the United Nations (Privileges and Immunities) Act, 1947 grants exemption from income-tax to salaries and emoluments paid by the United Nations to its officials. Besides salary, any pension covered under the United Nations (Privileges and Immunities) Act and received from UNO is also exempt from tax.

1.18 Allowances

Different types of allowances are given to employees by their employers. Generally allowances are given to employees to meet some particular requirements like house rent, expenses on uniform, conveyance etc. Under the Income-tax Act, 1961, allowance is taxable on due or receipt basis, whichever is earlier. Various types of allowances normally in vogue

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are discussed below:

Allowances		
Fully Taxable	Partly Taxable	Fully Exempt
(i) Entertainment Allowance	(i) House Rent Allowance [u/s 10(13A)]	(i) Allowance granted to Government employees outside India.
(ii) Dearness Allowance	(ii) Special Allowances [u/s 10(14)]	(ii) Sumptuary allowance granted to High Court or Supreme Court Judges
(iii) Overtime Allowance		(iii) Allowance paid by the United Nations Organization.
(iv) Fixed Medical Allowance		(iv) Compensatory Allowance received by a judge
(v) City Compensatory Allowance		
(vi) Interim Allowance (to meet increased cost of living in cities)		
(vii) Servant Allowance		
(viii) Project Allowance		
(ix) Tiffin/Lunch/Dinner Allowance		
(x) Any other cash allowance		
(xi) Warden Allowance		
(xii) Non-practicing Allowance		

Allowances which are fully taxable

(1) **City compensatory allowance:** City Compensatory Allowance is normally intended to compensate the employees for the higher cost of living in cities. It is taxable irrespective of the fact whether it is given as compensation for performing his duties in a particular place or under special circumstances.

(2) **Entertainment allowance:** This allowance is given to employees to meet the expenses towards hospitality in receiving customers etc. The Act gives a deduction towards entertainment allowance only to a Government employee. The details of deduction permissible are discussed later on in this Unit.

Allowances which are partially taxable:

(1) **House rent allowance [Section 10(13A)] :** Refer to Chapter 3 for detailed discussion.

(2) **Special allowances [Section 10(14)] :** Refer to Chapter 3 for details.

Allowances which are fully exempt:

(1) **Allowance to High Court Judges:** Any allowance paid to a Judge of a High Court under section 22A(2) of the High Court Judges (Conditions of Service) Act, 1954 is not taxable.

(2) **Allowance received from United Nations Organisation (UNO):** Allowance paid by the UNO to its employees is not taxable by virtue of section 2 of the United Nations (Privileges and Immunities) Act, 1974.

(3) **Compensatory allowance under Article 222(2) of the Constitution:** Compensatory allowance received by judge under Article 222(2) of the Constitution is not taxable since it is neither salary nor perquisite—*Bishamber Dayal v. CIT* [1976] 103 ITR 813 (MP).

(4) **Sumptuary allowance:** Sumptuary allowance given to High Court Judges under section 22C of the High Court Judges (Conditions of Service) Act, 1954 and Supreme Court Judges under section 23B of the Supreme Court Judges (Conditions of Service) Act, 1958 is not chargeable to tax.

1.19 Perquisites

(1) The term 'perquisite' indicates some extra benefit in addition to the amount that may be legally due by way of contract for services rendered. In modern times, the salary package of an employee normally includes monetary salary and perquisite like housing, car etc.

(2) Perquisite may be provided in cash or in kind.

(3) Reimbursement of expenses incurred in the official discharge of duties is not a perquisite.

(4) Perquisite may arise in the course of employment or in the course of profession. If it arises from a relationship of employer-employee, then the value of the perquisite is taxable as salary. However, if it arises during the course of profession, the value of such perquisite is chargeable as profits and gains of business or profession.

(5) Perquisite will become taxable only if it has a legal origin. An unauthorised advantage taken by an employee without his employer's sanction cannot be considered as a perquisite under the Act. For example, suppose A, an employee, is given a house by his employer. On 31.3.2014, he is terminated from service. But he continues to occupy the house without the permission of the employer for six more months after which he is evicted by the employer. The question arises whether the value of the benefit enjoyed by him during the six months period can be considered as a perquisite and be charged to salary. It cannot be done since the relationship of employer-employee ceased to exist after 31.3.2014. However, the definition of income is wide enough to bring the value of the benefit enjoyed by employee to tax as "income from other sources".

(6) Income-tax paid by the employer out of his pocket on the salary of the employee is a perquisite in the hands of the employee whether the payment is contractual or voluntary.

Definition: Under the Act, the term 'perquisite' is defined by section 17(2) to include the following:

- (a) the value of rent free accommodation provided to the assessee by his employer [section 17(2)(i)];
- (b) The value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer [section 17(2)(ii)];

- (i) Under section 17(2)(ii), the value of any concession in the matter of rent arising to an employee in respect of any accommodation provided by his employer is considered as "perquisite" chargeable to tax in the hands of the employee.
- (ii) Rule 3(1) of the Income-tax Rules provides the basis of valuation of perquisites in respect of accommodation provided to an employee, as under:
 - (a) 15% of salary in cities having population exceeding 25 lakh
 - (b) 10% of salary in cities having population above 10 lakh up to 25 lakh
 - (b) 7.5% of salary in cities having population up to 10 lakh.
- (iii) In case of furnished accommodation provided by an employer, the value arrived as above was to be further increased by 10 per cent of the cost of furniture, where the same is owned by the employer, or the actual hire charges paid by the employer in case the furniture is hired.
- (iv) This method of perquisite valuation resulted in genuine hardship to employees availing facility of residential accommodation in remote areas, as the value of perquisite was determined as a percentage of salary of the employee, irrespective of the fair rental value of the property (which may be much lower than 15%/10%/7.5% of salary in such cases).
- (v) Rule 3(1) was challenged as *ultra vires* before the Supreme Court in the case of *Arun Kumar v. UOI (2006) 286 ITR 89*. The Apex court, while holding that the provisions of Rule 3(1) were constitutionally valid, observed that the same would be applicable only if 'concession in the matter of rent' with respect to the accommodation provided by an employer accrues to the employee under the substantive provisions of section 17(2)(ii). The Assessing Officer, before applying Rule 3(1), was required to establish that there was 'concession in the matter of rent' provided to the employee.
- (vi) Further, as per the Apex court, the difference between the value as per Rule 3(1) and the rent recovered from the employee, could not per se be considered as 'concession in the matter of rent' provided to the employee.
- (vii) In order to clarify the correct intent of law, Explanations have been inserted in section 17(2)(ii) to provide that the difference between the specified rate (as shown in column 2 of the table below) and the amount of rent recoverable/recovered from the employee would be deemed to be the concession in the matter of rent in case of accommodation owned by the employer. In case of accommodation taken on lease or rent by the employer, the difference between the actual lease rent or 15% of salary, whichever is lower, and rent recovered/recoverable from the employee would be deemed to be the concession in the matter of rent.

(1)	(2)
Type of accommodation	Deemed concession in the matter of rent
Accommodation owned by the employer	
In cities having a population exceeding 25 lakh	15% of salary minus rent recoverable from the employee.
In cities having a population exceeding 10 lakh but not exceeding 25 lakh	10% of salary minus rent recoverable from the employee.
In other cities	7½% of salary minus rent recoverable from employee.
Accommodation taken on lease by the employer	Rent paid by the employer or 15% of salary, whichever is lower, minus rent recoverable from the employee.

- (viii) This deeming provision is applicable to employees other than Government employees. In case of furnished accommodation provided to such employees, the excess of hire charges paid or 10% p.a. of cost of furniture, as the case may be, over and above the charges paid or payable by the employee would be added to the value determined in column (2) above for determining whether there is a concession in the matter of rent.

Note – Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

- (ix) "Salary" includes pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called, from one or more employers, as the case may be. However, it does not include the following, namely–
- (1) dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;
 - (2) employer's contribution to the provident fund account of the employee;
 - (3) allowances which are exempted from the payment of tax;
 - (4) value of the perquisites specified in section 17(2);
 - (5) any payment or expenditure specifically excluded under the proviso to section 17(2) i.e., medical expenditure/payment of medical insurance premium specified therein.
- (x) In case of Government employees, the excess of licence fees determined by the employer as increased by the value of furniture and fixture over and above the rent recovered/recoverable from the employee and the charges paid or payable for furniture by the employee would be deemed to be the concession in the matter of rent.

- (c) The value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases (i.e. in case of specified employees):
 - (i) by a company to an employee in which he is a director;
 - (ii) by a company to an employee being a person who has substantial interest in the company (i.e. 20% or more of the voting rights of the company);
 - (iii) by any employer (including a company) to an employee to whom the provisions of (i) & (ii) do not apply and whose income under the head 'salaries' (whether due from, or paid or allowed by, one or more employers) exclusive of the value of all benefits or amenities not provided for by way of monetary benefits exceeds ₹ 50,000 [Section 17(2)(iii)];
- (d) Any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee [Section 17(2)(iv)];
- (e) Any sum payable by the employer whether directly or through a fund, other than a recognised provident fund or approved superannuation fund or deposit-linked insurance fund to effect an assurance on the life of the assessee or to effect a contract for an annuity [Section 17(2)(v)];
- (f) the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer or former employer, free of cost or at concessional rate to the assessee [Section 17(2)(vi)];

Specified security means "securities" as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956. It also includes the securities offered under employees stock option plan or scheme. Sweat equity shares means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

The value of specified security or sweat equity shares shall be the fair market value of such security or shares on the date on which the option is exercised by the assessee, as reduced by any amount actually paid by, or recovered from, the assessee in respect of such security or shares. The fair market value means the value determined in accordance with the method as may be prescribed by the CBDT. "Option" means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a pre-determined price.

- (g) the amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds ₹ 1 lakh [Section 17(2)(vii)];
- (h) the value of any other fringe benefit or amenity as may be prescribed by the CBDT [Section 17(2)(viii)].

It can be noted that the aforesaid definition of perquisite is an inclusive one. More terms can be added in.

Types of perquisites: Perquisites may be divided into three broad categories:

- (1) Perquisites taxable in the case of all employees
- (2) Perquisites exempt from tax in the case of all employees
- (3) Perquisites taxable only in the hands of specified employees.

(1) Perquisites taxable in the case of all employees: The following perquisites are chargeable to tax in all cases.

- (i) Value of rent-free accommodation provided to the assessee by his employer [Section 17(2)(i)].

Exception: Rent-free official residence provided to a Judge of a High Court or to a Judge of the Supreme Court is not taxable. Similarly, rent-free furnished house provided to an Officer of Parliament, is not taxable. [For valuation, refer to para 1.20]

- (ii) Value of concession in rent in respect of accommodation provided to the assessee by his employer [Section 17(2)(ii)].
- (iii) Amount paid by an employer in respect of any obligation which otherwise would have been payable by the employee [Section 17(2)(iv)]. For example, if a domestic servant is engaged by an employee and the employer reimburses the salary paid to the servant, it becomes an obligation which the employee would have discharged even if the employer did not reimburse the same. This perquisite will be covered by section 17(2)(iv) and will be taxable in the hands of all employees.
- (iv) Amount payable by an employer directly or indirectly to effect an assurance on the life of the assessee or to effect a contract for an annuity, other than payment made to RPF or approved superannuation fund or deposit-linked insurance fund established under the Coal Mines Provident Fund or Employees' Provident Fund Act. However, there are schemes like group annuity scheme, employees state insurance scheme and fidelity insurance scheme, under which insurance premium is paid by employer on behalf of the employees. Such payments are not regarded as perquisite in view of the fact that the employees have only an expectancy of the benefit in such schemes.
- (v) the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer or former employer, free of cost or at concessional rate to the assessee.
- (vi) the amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds ₹ 1 lakh.
- (vii) The value of any other fringe benefit or amenity as may be prescribed by the CBDT.

(2) Perquisites exempt from tax in all cases: The following perquisites are exempt from tax in all cases -

- (1) Telephone provided by an employer to an employee at his residence;
- (2) Goods sold by an employer to his employees at concessional rates;

- (3) Transport facility provided by an employer engaged in the business of carrying of passengers or goods to his employees either free of charge or at concessional rate;
 - (4) Privilege passes and privilege ticket orders granted by Indian Railways to its employees;
 - (5) Perquisites allowed outside India by the Government to a citizen of India for rendering services outside India;
 - (6) Sum payable by an employer to a RPF or an approved superannuation fund or deposit-linked insurance fund established under the Coal Mines Provident Fund or the Employees' Provident Fund Act;
 - (7) Employer's contribution to staff group insurance scheme;
 - (8) Leave travel concession;
 - (9) Payment of annual premium by employer on personal accident policy effected by him on the life of the employee;
 - (10) Refreshment provided to all employees during working hours in office premises;
 - (11) Subsidized lunch or dinner provided to an employee;
 - (12) Recreational facilities, including club facilities, extended to employees in general *i.e.*, not restricted to a few select employees;
 - (13) Amount spent by the employer on training of employees or amount paid for refresher management course including expenses on boarding and lodging;
 - (14) Medical facilities subject to certain prescribed limits; [Refer to point 10 of para 1.20]
 - (15) Rent-free official residence provided to a Judge of a High Court or the Supreme Court;
 - (16) Rent-free furnished residence including maintenance provided to an Officer of Parliament, Union Minister and a Leader of Opposition in Parliament;
 - (17) Conveyance facility provided to High Court Judges under section 22B of the High Court Judges (Conditions of Service) Act, 1954 and Supreme Court Judges under section 23A of the Supreme Court Judges (Conditions of Service) Act, 1958.
- (3) **Perquisites taxable only in the hands of specified employees [Section 17(2)(iii)]:** The value of any benefit or amenity granted or provided free of cost or at concessional rate which have not been included in 1 & 2 above will be taxable in the hands of specified employees:

Specified employees are:

- (i) **Director employee:** An employee of a company who is also a director is a specified employee. It is immaterial whether he is a full-time director or part-time director. It also does not matter whether he is a nominee of the management, workers, financial institutions or the Government. It is also not material whether or not he is a director throughout the previous year.
- (ii) **An employee who has substantial interest in the company:** An employee of a company who has substantial interest in that company is a specified employee. A person has a substantial interest in a company if he is a beneficial owner of equity shares carrying 20% or more of the voting power in the company.

Beneficial and legal ownership: In order to determine whether a person has a substantial interest in a company, it is the beneficial ownership of equity shares carrying 20% or more of the voting power that is relevant rather than the legal ownership.

Example: A, Karta of a HUF, is a registered shareholder of Bright Ltd. The amount for purchasing the shares is financed by the HUF. The dividend is also received by the HUF. Supposing further that A is the director in Bright Ltd., the question arises whether he is a specified employee. In this case, he cannot be called a specified person since he has no beneficial interest in the shares registered in his name. It is only for the purpose of satisfying the statutory requirements that the shares are registered in the name of A. All the benefits arising from the shareholding goes to the HUF. Conversely, it may be noted that an employee who is not a registered shareholder will be considered as a specified employee if he has beneficial interest in 20% or more of the equity shares in the company.

(iii) Employee drawing in excess of ₹ 50,000: An employee other than an employee described in (i) & (ii) above, whose income chargeable under the head 'salaries' exceeds ₹ 50,000 is a specified employee. The above salary is to be considered exclusive of the value of all benefits or amenities not provided by way of monetary payments.

In other words, for computing the limit of ₹ 50,000, the following items have to be excluded or deducted:

- (a) all non-monetary benefits;
- (b) monetary benefits which are exempt under section 10. This is because the exemptions provided under section 10 are excluded completely from salaries. For example, HRA or education allowance or hostel allowance are not to be included in salary to the extent to which they are exempt under section 10.
- (c) Deduction for entertainment allowance [under section 16(ii)] and deduction toward professional tax [under section 16(iii)] are also to be excluded.

If an employee is employed with more than one employer, the aggregate of the salary received from all employers is to be taken into account in determining the above ceiling limit of ₹ 50,000, i.e. Salary for this purpose

= Basic Salary + Dearness Allowance + Commission, whether payable monthly or turnover based + Bonus + Fees + Any other taxable payment + Any taxable allowances + Any other monetary benefits – Deductions under section 16]

1.20 Valuation of Perquisites

The Income-tax Rules, 1962 contain the provisions for valuation of perquisites. It is important to note that only those perquisites which the employee actually enjoys have to be valued and taxed in his hand. For example, suppose a company offers a housing accommodation rent-free to an employee but the latter declines to accept it, then the value of such accommodation obviously cannot be evaluated and taxed in the hands of the employees. For the purpose of

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computing the income chargeable under the head "Salaries", the value of perquisites provided by the employer directly or indirectly to the employee or to any member of his household by reason of his employment shall be determined in accordance with new Rule 3.

(1) Valuation of residential accommodation [Sub-rule (1)] - The value of residential accommodation provided by the employer during the previous year shall be determined in the following manner –

Sl. No.	Circumstances	In case of unfurnished accommodation	In case of furnished accommodation
(1)	(2)	(3)	(4)
(1)	Where the accommodation is provided by the Central Government or any State Government to the employees either holding office or post in connection with the affairs of the Union or of such State.	License fee determined by the Central Government or any State Government in respect of accommodation in accordance with the rules framed by such Government as reduced by the rent actually paid by the employee.	The value of perquisite as determined under column (3) and increased by 10% per annum of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment). If such furniture is hired from a third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year should be added to the value of the perquisite determined under column (3).
(2)	Where the accommodation is provided by any other employer (a) where the accommodation is owned by the employer	(i) 15% of salary in cities having population exceeding 25 lakhs as per 2001 census; (ii) 10% of salary in cities having population exceeding 10 lakhs	The value of perquisite as determined under column (3) and increased by 10% per annum of the cost of furniture (including television sets, refrigerators, other household appliances, air-conditioning plant or equipment or other similar appliances or gadgets). If such furniture is hired from a

		<p>but not exceeding 25 lakhs as per 2001 census;</p> <p>(iii) 7.5% of salary in other areas, in respect of the period during which the said accommodation was occupied by the employee during the previous year as reduced by the rent, if any, actually paid by the employee.</p>	<p>third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year, should be added to the value of perquisite determined under column (3).</p>
	(b) where the accommodation is taken on lease or rent by the employer.	<p>Actual amount of lease rental paid or payable by the employer or 15% of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee.</p>	<p>The value of perquisite as determined under column (3) and increased by 10% per annum of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment or other similar appliances or gadgets).</p> <p>If such furniture is hired from a third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year should be added to the value of perquisite determined under column (3).</p>
(3)	Where the accommodation is provided by any employer, whether Government or any other employer, in a hotel.	Not applicable	<p>24% of salary paid or payable for the previous year or the actual charges paid or payable to such hotel, which is lower, for the period during which such accommodation is provided as reduced by the rent, if any,</p>

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			actually paid or payable by the employee. However, where the employee is provided such accommodation for a period not exceeding in aggregate fifteen days on his transfer from one place to another, there would be no perquisite.
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Notes:

- (1) If an employee is provided with accommodation, on account of his transfer from one place to another, at the new place of posting while retaining the accommodation at the other place, the value of perquisite shall be determined with reference to only one such accommodation which has the lower perquisite value, as calculated above, for a period not exceeding 90 days and thereafter, the value of perquisite shall be charged for both such accommodations.
- (2) Any accommodation provided to an employee working at a mining site or an on-shore oil exploration site or a project execution site, or a dam site or a power generation site or an off-shore site would not be treated as a perquisite, provided it satisfies either of the following conditions -
 - (i) the accommodation is of temporary nature, has plinth area not exceeding 800 square feet and is located not less than eight kilometers away from the local limits of any municipality or a cantonment board; or
 - (ii) the accommodation is located in a remote area i.e. an area that is located at least 40 kms away from a town having a population not exceeding 20,000 based on latest published all-India census.
- (3) Where the accommodation is provided by the Central Government or any State Government to an employee who is serving on deputation with any body or undertaking under the control of such Government,-
 - (i) the employer of such an employee shall be deemed to be that body or undertaking where the employee is serving on deputation; and
 - (ii) the value of perquisite of such an accommodation shall be the amount calculated in accordance with Sl. No.(2)(a) of the above table, as if the accommodation is owned by the employer.
- (4) "Accommodation" includes a house, flat, farm house or part thereof, or accommodation in a hotel, motel, service apartment, guest house, caravan, mobile home, ship or other floating structure.
- (5) "Hotel" includes licensed accommodation in the nature of motel, service apartment or guest house.

Illustration 4

Mr. C is a Finance Manager in ABC Ltd. The company has provided him with rent-free unfurnished accommodation in Mumbai. He gives you the following particulars:

<i>Basic salary</i>	<i>₹ 6,000 p.m.</i>
<i>Advance salary for April 2015</i>	<i>₹ 5,000</i>
<i>Dearness Allowance</i>	<i>₹ 2,000 p.m. (30% is for retirement benefits)</i>
<i>Bonus</i>	<i>₹ 1,500 p.m.</i>

Even though the company allotted the house to him on 1.4.2014, he occupied the same only from 1.11.2014. Calculate the taxable value of the perquisite for A.Y. 2015-16.

Solution

Value of the rent free unfurnished accommodation

= 15% of salary for the relevant period

= 15% of [(₹ 6000 × 5) + (₹ 2,000 × 30% × 5) + (₹ 1,500 × 5)] [See Note below]

= 15% of ₹ 40,500 = ₹ 6,075.

Note: Since, Mr. C occupies the house only from 1.11.2014, we have to include the salary due to him only in respect of months during which he has occupied the accommodation. Hence salary for 5 months (i.e. from 1.11.2014 to 31.03.2015) will be considered. Advance salary for April 2015 drawn during this year is not to be considered because it falls in respect of a period beyond the relevant previous year.

Illustration 5

Using the data given in the previous illustration 4, compute the value of the perquisite if Mr. C is required to pay a rent of ₹ 1,000 p.m. to the company, for the use of this accommodation.

Solution

First of all, we have to see whether there is a concession in the matter of rent. In the case of accommodation owned by the employer in cities having a population exceeding ₹ 25 lakh, there would be deemed to be a concession in the matter of rent if 15% of salary exceeds rent recoverable from the employee.

In this case, 15% of salary would be ₹ 6,075 (i.e. 15% of ₹ 40,500). The rent paid by the employee is ₹ 5,000 (i.e. ₹ 1,000 × 5). Since 15% of salary exceeds the rent recovered from the employee, there is a deemed concession in the matter of rent. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation	= ₹ 6,075
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Less : Rent paid by the employee (₹ 1,000 × 5)	= ₹ 5,000
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Perquisite value of unfurnished accommodation given at concessional rent	= ₹ 1,075
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Illustration 6

Using the data given in illustration 4, compute the value of the perquisite if ABC Ltd. has taken this accommodation on a lease rent of ₹ 1,200 p.m. and Mr. C is required to pay a rent of ₹ 1,000 p.m. to the company, for the use of this accommodation.

Solution

Here again, we have to see whether there is a concession in the matter of rent. In the case of accommodation taken on lease by the employer, there would be deemed to be a concession in the matter of rent if the rent paid by the employer or 15% of salary, whichever is lower, exceeds rent recoverable from the employee.

In this case, 15% of salary is ₹ 6,075 (i.e. 15% of ₹ 40,500). Rent paid by the employer is ₹ 6,000 (i.e. ₹ 1,200 x 5). The lower of the two is ₹ 6,000, which exceeds the rent paid by the employee i.e. ₹ 5,000 (₹ 1,000 x 5). Therefore, there is a deemed concession in the matter of rent. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation [Note1] = ₹ 6,000

Less: Rent paid by the employee (₹ 1,000 x 5) = ₹ 5,000

∴ Value of unfurnished accommodation given at concessional rent = ₹ 1,000

Note 1 : Value of the rent free unfurnished accommodation is lower of

(i) Lease rent paid by the company for relevant period = ₹ 1,200 × 5 = ₹ 6,000

(ii) 15% of salary for the relevant period (computed earlier) = ₹ 6,075

Illustration 7

Using the data given in illustration 4, compute the value of the perquisite if ABC Ltd. has provided a television (WDV ₹ 10,000; Cost ₹ 25,000) and two air conditioners. The rent paid by the company for the air conditioners is ₹ 400 p.m. each. The television was provided on 1.1.2015. However, Mr. C is required to pay a rent of ₹ 1,000 p.m. to the company, for the use of this furnished accommodation.

Solution

Here again, we have to see whether there is a concession in the matter of rent. In the case of accommodation owned by the employer in a city having a population exceeding ₹ 25 lakh, there would be deemed to be a concession in the matter of rent if 15% of salary exceeds rent recoverable from the employee. In case of furnished accommodation, the excess of hire charges paid or 10% p.a. of the cost of furniture, as the case may be, over and above the charges paid or payable by the employee has to be added to the value arrived at above to determine whether there is a concession in the matter of rent.

In this case, 15% of salary is ₹ 6,075 (i.e. 15% of ₹ 40,500). The rent paid by the employee is ₹ 5,000 (i.e. ₹ 1,000 x 5). The value of furniture (see Note 1 below) to be added to 15% of salary is ₹ 4,625. The deemed concession in the matter of rent is ₹ 6,075 + ₹ 4,625 - ₹ 5,000 = ₹ 5,700. Once there is a deemed concession, the provisions of Rule 3(1) would be

applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation (computed earlier)	= ₹ 6,075
Add: Value of furniture provided by the employer [Note 1]	= ₹ 4,625
Value of rent free furnished accommodation	= ₹ 10,700
Less: Rent paid by the employee (₹ 1,000 × 5)	= ₹ 5,000
Value of furnished accommodation given at concessional rent	= ₹ 5,700

Note 1: Value of the furniture provided = (₹ 400 p.m. × 2 × 5 months) + (₹ 25,000 × 10% p.a. for 3 months) = ₹ 4,000 + ₹ 625 = ₹ 4,625

Illustration 8

Using the data given in illustration 7 above, compute the value of the perquisite if Mr. C is a government employee. The licence fees determined by the Government for this accommodation was ₹ 700 p.m.

Solution

In the case of Government employees, the excess of licence fees determined by the employer as increased by the value of furniture and fixture over and above the rent recovered/recoverable from the employee and the charges paid or payable for furniture by the employee would be deemed to be the concession in the matter of rent. Therefore, the deemed concession in the matter of rent is ₹ 3,125 [i.e. ₹ 3,500 (licence fees: 700 × 5) + ₹ 4,625 (Value of furniture) – ₹ 5,000 (₹ 1,000 × 5)]. Once there is a deemed concession, the provisions of Rule 3(1) would be applicable in computing the taxable perquisite.

Value of the rent free unfurnished accommodation (₹ 700 × 5)	= ₹ 3,500
Add: Value of furniture provided by the employer (computed earlier)	= ₹ 4,625
Value of rent free furnished accommodation	= ₹ 8,125
Less: Rent paid by the employee (₹ 1,000 × 5)	= ₹ 5,000
Perquisite value of furnished accommodation given at concessional rent	= ₹ 3,125

(2) Motor Car [Sub-rule (2) of Rule 3] - The value of perquisite by way of use of motor car to an employee by an employer shall be determined in the following manner -

VALUE OF PERQUISITE PER CALENDAR MONTH

Sl. No.	Circumstances	Where cubic capacity of engine does not exceed 1.6 litres	Where cubic capacity of engine exceeds 1.6 litres
(1)	(2)	(3)	(4)
(1)	Where the motor car is owned or hired by the employer and –		

4.26 Income-tax

(a)	is used wholly and exclusively in the performance of his official duties	Not a perquisite, provided the documents specified in Note (2) below the table are maintained by the employer.	Not a perquisite, provided the documents specified in Note (2) below the table are maintained by the employer.
(b)	is used exclusively for the private or personal purposes of the employee or any member of his household and the running and maintenance expenses are met or reimbursed by the employer;	Actual amount of expenditure incurred by the employer on the running and maintenance of motor car during the relevant previous year including remuneration, if any, paid by the employer to the chauffeur as increased by the amount representing normal wear and tear of the motor car and as reduced by any amount charged from the employee for such use.	Actual amount of expenditure incurred by the employer on the running and maintenance of motor car during the relevant previous year including remuneration, if any, paid by the employer to the chauffeur as increased by the amount representing normal wear and tear of the motor car and as reduced by any amount charged from the employee for such use.
(c)	is used partly in the performance of duties and partly for private or personal purposes of his own or any member of his household and-		
	(i) the expenses on maintenance and running are met or reimbursed by the employer	₹ 1,800 (plus ₹ 900, if chauffeur is also provided to run the motor car)	₹ 2,400 (plus ₹ 900, if chauffeur is also provided to run the motor car)
	(ii) the expenses on running and maintenance for private or personal use are fully met by the assessee.	₹ 600 (plus ₹ 900, if chauffeur is also provided by the employer to run the motor car)	₹ 900 (plus ₹ 900, if chauffeur is also provided by the employer to run the motor car)

(2)	Where the employee owns a motor car but the actual running and maintenance charges (including remuneration of the chauffeur, if any) are met or reimbursed to him by the employer and –		
(i)	such reimbursement is for the use of the vehicle wholly and exclusively for official purposes	Not a perquisite, provided the documents specified in Note (2) below the table are maintained by the employer.	Not a perquisite, provided the documents specified in Note (2) below the table are maintained by the employer.
(ii)	such reimbursement is for the use of the vehicle partly for official purposes and partly for personal or private purposes of the employee or any member of his household.	The actual amount of expenditure incurred by the employer as reduced by the amount specified in Sl. No. (1)(c)(i) above (Also see note (2) below this table).	The actual amount of expenditure incurred by the employer as reduced by the amount specified in Sl. No. (1)(c)(i) above (Also see note (2) below this table).
(3)	Where the employee owns any other automotive conveyance but the actual running and maintenance charges are met or reimbursed to him by the employer and		
(i)	such reimbursement is for the use of the vehicle wholly and exclusively for official purposes	Not a perquisite, provided the documents specified in the note (2) below the table are maintained by the employer.	Not applicable.
(ii)	such reimbursement is for the use of vehicle partly for official purposes and partly for personal or private purposes of the employee	The actual amount of expenditure incurred by the employer as reduced by the amount of ₹ 900. (Also see note (2) below the table)	

Notes:

- (1) Where one or more motor-cars are owned or hired by the employer and the employee or any member of his household are allowed the use of such motor-car or all of any of such motor-cars (otherwise than wholly and exclusively in the performance of his duties), the value of perquisite shall be the amount calculated in respect of one car as if the employee had been provided one motor-car for use partly in the performance of his duties and partly for his private or personal purposes and the amount calculated in respect of the other car or cars as if he had been provided with such car or cars exclusively for his private or personal purposes.
 - (2) Where the employer or the employee claims that the motor-car is used wholly and exclusively in the performance of official duty or that the actual expenses on the running and maintenance of the motor-car owned by the employee for official purposes is more than the amounts deductible in Sl. No. 2(ii) or 3(ii) of the above table, he may claim a higher amount attributable to such official use and the value of perquisite in such a case shall be the actual amount of charges met or reimbursed by the employer as reduced by such higher amount attributable to official use of the vehicle provided that the following conditions are fulfilled :-
 - (a) the employer has maintained complete details of journey undertaken for official purpose which may include date of journey, destination, mileage, and the amount of expenditure incurred thereon;
 - (b) the employer gives a certificate to the effect that the expenditure was incurred wholly and exclusively for the performance of official duties.
 - (3) For computing the perquisite value of motor car, the normal wear and tear of a motor-car shall be taken at 10% per annum of the actual cost of the motor-car or cars.
- (3) Valuation of benefit of provision of domestic servants [Sub-rule (3) of Rule 3]**
- (i) The value of benefit to the employee or any member of his household resulting from the provision by the employer of the services of a sweeper, a gardener, a watchman or a personal attendant, shall be the actual cost to the employer.
 - (ii) The actual cost in such a case shall be the total amount of salary paid or payable by the employer or any other person on his behalf for such services as reduced by any amount paid by the employee for such services.
- (4) Valuation of gas, electricity or water supplied by employer [Sub-rule (4) of Rule 3]**
- (i) The value of the benefit to the employee resulting from the supply of gas, electric energy or water for his household consumption shall be determined as the sum equal to the amount paid on that account by the employer to the agency supplying the gas, electric energy or water.

- (ii) Where such supply is made from resources owned by the employer, without purchasing them from any other outside agency, the value of perquisite would be the manufacturing cost per unit incurred by the employer.
- (iii) Where the employee is paying any amount in respect of such services, the amount so paid shall be deducted from the value so arrived at.

(5) Valuation of free or concessional educational facilities [Sub-rule (5) of Rule 3]

- (i) The value of benefit to the employee resulting from the provision of free or concessional educational facilities for any member of his household shall be determined as the sum equal to the amount of expenditure incurred by the employer in that behalf or where the educational institution is itself maintained and owned by the employer or where free educational facilities for such member of employees' household are allowed in any other educational institution by reason of his being in employment of that employer, the value of the perquisite to the employee shall be determined with reference to the cost of such education in a similar institution in or near the locality.
- (ii) Where any amount is paid or recovered from the employee on that account, the value of benefit shall be reduced by the amount so paid or recovered.
- (iii) However, where the educational institution itself is maintained and owned by the employer and free educational facilities are provided to the children of the employee or where such free educational facilities are provided in any institution by reason of his being in employment of that employer, there would be no perquisite if the cost of such education or the value of such benefit per child does not exceed ₹ 1,000 p.m.

(6) Free or concessional tickets [Sub-rule (6) of Rule 3] - The value of any benefit or amenity resulting from the provision by an employer who is engaged in the carriage of passengers or goods, to any employee or to any member of his household for personal or private journey free of cost or at concessional fare, in any conveyance owned, leased or made available by any other arrangement by such employer for the purpose of transport of passengers or goods shall be taken to be the value at which such benefit or amenity is offered by such employer to the public as reduced by the amount, if any, paid by or recovered from the employee for such benefit or amenity.

However, there would be no such perquisite to the employees of an airline or the railways.

(7) Valuation of other fringe benefits and amenities [Sub-rule (7) of Rule 3] - Section 17(2)(viii) provides that the value of any other fringe benefit or amenity as may be prescribed would be included in the definition of perquisite. Accordingly, the following other fringe benefits or amenities are prescribed and the value thereof shall be determined in the manner provided hereunder :-

(i) Interest-free or concessional loan [Sub-rule 7(i) of Rule 3]

- (a) The value of the benefit to the assessee resulting from the provision of interest-free or concessional loan for any purpose made available to the employee or any

member of his household during the relevant previous year by the employer or any person on his behalf shall be determined as the sum equal to the interest computed at the rate charged per annum by the State Bank of India, as on the 1st day of the relevant previous year in respect of loans for the same purpose advanced by it on the maximum outstanding monthly balance as reduced by the interest, if any, actually paid by him or any such member of his household. "Maximum outstanding monthly balance" means the aggregate outstanding balance for each loan as on the last day of each month.

- (b) However, no value would be charged if such loans are made available for medical treatment in respect of prescribed diseases (like cancer, tuberculosis, etc.) or where the amount of loans are petty not exceeding in the aggregate ₹ 20,000.
- (c) Further, where the benefit relates to the loans made available for medical treatment referred to above, the exemption so provided shall not apply to so much of the loan as has been reimbursed to the employee under any medical insurance scheme.

(ii) Travelling, touring and accommodation [Sub-rule 7(ii) of Rule 3]

- (a) The value of travelling, touring, accommodation and any other expenses paid for or borne or reimbursed by the employer for any holiday availed of by the employee or any member of his household, other than leave travel concession or assistance, shall be determined as the sum equal to the amount of the expenditure incurred by such employer in that behalf.
- (b) Where such facility is maintained by the employer, and is not available uniformly to all employees, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public.
- (c) Where the employee is on official tour and the expenses are incurred in respect of any member of his household accompanying him, the amount of expenditure so incurred shall also be a fringe benefit or amenity.
- (d) However, where any official tour is extended as a vacation, the value of such fringe benefit shall be limited to the expenses incurred in relation to such extended period of stay or vacation. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity.

(iii) Free or concessional food and non-alcoholic beverages [Sub-rule 7(iii) of Rule 3]

- (a) The value of free food and non-alcoholic beverages provided by the employer to an employee shall be the amount of expenditure incurred by such employer. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity:
- (b) However, the following would not be treated as a perquisite -
 - (1) free food and non-alcoholic beverages provided by such employer during working hours at office or business premises or through paid vouchers which

are not transferable and usable only at eating joints, to the extent the value thereof either case does not exceed fifty rupees per meal or

- (2) tea or snacks provided during working hours or
- (3) free food and non-alcoholic beverages during working hours provided in a remote area or an off-shore installation.

(iv) Value of gift, voucher or token in lieu of such gift [Sub-rule 7(iv) of Rule 3]

- (a) The value of any gift, or voucher, or token in lieu of which such gift may be received by the employee or by member of his household on ceremonial occasions or otherwise from the employer shall be determined as the sum equal to the amount of such gift:
- (b) However, if the value of such gift, voucher or token, as the case may be, is below ₹ 5,000 in the aggregate during the previous year, the value of perquisite shall be taken as 'Nil'.

(v) Credit card expenses [Sub-rule 7(v) of Rule 3]

- (a) The amount of expenses including membership fees and annual fees incurred by the employee or any member of his household, which is charged to a credit card (including any add-on-card) provided by the employer, or otherwise, paid for or reimbursed by such employer shall be taken to be the value of perquisite chargeable to tax as reduced by the amount, if any paid or recovered from the employee for such benefit or amenity.
- (b) However, such expenses incurred wholly and exclusively for official purposes would not be treated as a perquisite if the following conditions are fulfilled.
 - (1) complete details in respect of such expenditure are maintained by the employer which may, inter alia, include the date of expenditure and the nature of expenditure;
 - (2) the employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.

(vi) Club expenditure [Sub-rule 7(vi) of Rule 3]

- (a) The value of benefit to the employee resulting from the payment or reimbursement by the employer of any expenditure incurred (including the amount of annual or periodical fee) in a club by him or by a member of his household shall be determined to be the actual amount of expenditure incurred or reimbursed by such employer on that account. The amount so determined shall be reduced by the amount, if any, paid or recovered from the employee for such benefit or amenity.
- However, where the employer has obtained corporate membership of the club and the

facility is enjoyed by the employee or any member of his household, the value of perquisite shall not include the initial fee paid for acquiring such corporate membership.

- (b) Further, if such expenditure is incurred wholly and exclusively for business purposes, it would not be treated as a perquisite provided the following conditions are fulfilled:-
- (1) complete details in respect of such expenditure are maintained by the employer which may, *inter alia*, include the date of expenditure, the nature of expenditure and its business expediency;
 - (2) the employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.
- (c) There would be no perquisite for use of health club, sports and similar facilities provided uniformly to all employees by the employer.

(vii) **Use of moveable assets [Sub-rule 7(vii) of Rule 3]** - Value of perquisite is determined as under:

Asset given	Value of benefit
(a) Use of laptops and computers	Nil
(b) Movable assets, other than - (i) laptops and computers; and (ii) assets already specified	10% p.a. of the actual cost of such asset, or the amount of rent or charge paid, or payable by the employer, as the case may be

Note: Where the employee is paying any amount in respect of such asset, the amount so paid shall be deducted from the value of perquisite determined above.

(viii) **Transfer of moveable assets [Sub-rule 7(viii) of Rule 3]** -Value of perquisite is determined as under:

Assets transferred	Value of perquisite
Computers and electronic items	Depreciated value of asset [depreciation is computed @ 50% on WDV for each completed year of usage]
Motor cars	Depreciated value of asset [depreciation is computed @ 20% on WDV for each completed year of usage]
Any other asset	Depreciated value of asset [depreciation is computed @ 10% on SLM for each completed year of usage]

Note: Where the employee is paying any amount in respect of such asset, the amount so paid shall be deducted from the value of perquisite determined above.

(ix) **Other benefit or amenity [Sub-rule 7(ix) of Rule 3]** - The value of any other benefit or amenity, service, right or privilege provided by the employer shall be determined on the basis of cost to the employer under an arms' length transaction as reduced by the employee's contribution, if any. However, there will be no taxable perquisite in respect of expenses on telephones including mobile phone actually incurred on behalf of the employee by the employer i.e., if an employer pays or reimburses telephone bills or mobile phone charges of employee, there will be no taxable perquisite.

(8) **Valuation of specified security or sweat equity share for the purpose of section 17(2)(vi) [Sub-rule (8)]** - The fair market value of any specified security or sweat equity share, being an equity share in a company, on the date on which the option is exercised by the employee, shall be determined in the following manner -

(1) In a case where, on the date of the exercising of the option, the share in the company is listed on a recognized stock exchange, the fair market value shall be the average of the opening price and closing price of the share on that date on the said stock exchange.

However, where, on the date of exercising of the option, the share is listed on more than one recognized stock exchanges, the fair market value shall be the average of opening price and closing price of the share on the recognised stock exchange which records the highest volume of trading in the share.

Further, where on the date of exercising of the option, there is no trading in the share on any recognized stock exchange, the fair market value shall be—

- (a) the closing price of the share on any recognised stock exchange on a date closest to the date of exercising of the option and immediately preceding such date; or
- (b) the closing price of the share on a recognised stock exchange, which records the highest volume of trading in such share, if the closing price, as on the date closest to the date of exercising of the option and immediately preceding such date, is recorded on more than one recognized stock exchange.

"Closing price" of a share on a recognised stock exchange on a date shall be the price of the last settlement on such date on such stock exchange. However, where the stock exchange quotes both "buy" and "sell" prices, the closing price shall be the "sell" price of the last settlement.

"Opening price" of a share on a recognised stock exchange on a date shall be the price of the first settlement on such date on such stock exchange. However, where the stock exchange quotes both "buy" and "sell" prices, the opening price shall be the "sell" price of the first settlement.

(2) In a case where, on the date of exercising of the option, the share in the company is not listed on a recognised stock exchange, the fair market value shall be such value of the share in the company as determined by a merchant banker on the specified date.

For this purpose, "specified date" means,—

- (i) the date of exercising of the option; or
- (ii) any date earlier than the date of the exercising of the option, not being a date which is more than 180 days earlier than the date of the exercising.

Note: Where any amount has been recovered from the employee, the same shall be deducted to arrive at the value of perquisites.

(9) Valuation of specified security not being an equity share in a company for the purpose of section 17(2)(vi) [Sub-rule (9)] - The fair market value of any specified security, not being an equity share in a company, on the date on which the option is exercised by the employee, shall be such value as determined by a merchant banker on the specified date.

For this purpose, "specified date" means,—

- (i) the date of exercising of the option; or
- (ii) any date earlier than the date of the exercising of the option, not being a date which is more than 180 days earlier than the date of the exercising.

Definitions for the purpose of perquisite rules - The following definitions are relevant for applying the perquisite valuation rules -

- (i) "member of household" shall include-
 - (a) spouse(s),
 - (b) children and their spouses,
 - (c) parents, and
 - (d) servants and dependants;
- (ii) "Salary" includes the pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called from one or more employers, as the case may be, but does not include the following, namely:-
 - (a) dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;
 - (b) employer's contribution to the provident fund account of the employee;
 - (c) allowances which are exempted from payment of tax;
 - (d) the value of perquisites specified in clause (2) of section 17 of the Income-tax Act;
 - (e) any payment or expenditure specifically excluded under proviso to sub-clause (iii) of clause (2) or proviso to clause (2) of section 17;

- (f) lump-sum payments received at the time of termination of service or superannuation or voluntary retirement, like gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and similar payments;

Illustration 9

X Ltd. provided the following perquisites to its employee Mr. Y for the P.Y.2014-15 –

- (1) Accommodation taken on lease by X Ltd. for ₹ 15,000 p.m. ₹ 5,000 p.m. is recovered from the salary of Mr. Y.
- (2) Furniture, for which the hire charges paid by X Ltd. is ₹ 3,000 p.m. No amount is recovered from the employee in respect of the same.
- (3) A Santro Car which is owned by X Ltd. and given to Mr. Y to be used both for official and personal purposes. All running and maintenance expenses are fully met by the employer. He is also provided with a chauffeur.
- (4) A gift voucher of ₹ 10,000 on his birthday.

Compute the value of perquisites chargeable to tax for the A.Y.2015-16, assuming his salary for perquisite valuation to be ₹ 10 lakh.

Solution

Computation of the value of perquisites chargeable to tax in the hands of Mr. Y for the A.Y.2015-16

	Particulars	Amount in ₹		
(1)	Value of concessional accommodation			
	Actual amount of lease rental paid by X Ltd.	1,80,000		
	15% of salary i.e., 15% of ₹ 10,00,000	1,50,000		
	Lower of the above		1,50,000	
	Less: Rent paid by Mr. Y (₹ 5,000 × 12)		60,000	
			90,000	
	Add: Hire charges paid by X Ltd. for furniture provided for the use of Mr. Y		36,000	1,26,000
(2)	Perquisite value of santro car owned by X Ltd. and provided to Mr. Y for his personal and official use [(₹ 1,800 + ₹ 900) × 12]			32,400
(3)	Value of gift voucher			10,000
	Value of perquisites chargeable to tax			1,68,400

(10) Medical facilities - The following medical facilities will not amount to a perquisite:

- (i) The value of any medical treatment provided to an employee or any member of his family in any hospital maintained by the employer;

- (ii) Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family in any hospital maintained by the Government/local authority/any other hospital approved by the Government for the purpose of medical treatment of its employees;
- (iii) Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family in respect of the prescribed disease or ailments in any hospital approved by the Chief Commissioner having regard to the prescribed guidelines. However, in order to claim this benefit, the employee shall attach with his return of income a certificate from the hospital specifying the disease or ailment for which medical treatment was required and the receipt for the amount paid to the hospital.

Thus, the two types of facilities are covered:

- (a) payment by the employer for treatment in a Government hospital and
- (b) payment by an employer for treatment of prescribed diseases in any hospital approved by the Chief Commissioner.
- (iv) Any premium paid by an employer in relation to an employee to effect an insurance on the health of such employee. However, any such scheme should be approved by the Central Government or the Insurance Regulatory Development Authority (IRDA) for the purposes of section 36(1)(ib).
- (v) Any sum paid by the employer in respect of any premium paid by the employee to effect an insurance on his family under any scheme approved by the Central Government for the purposes of section 80D.
- (vi) Any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family to the extent of ₹ 15,000 in the previous year.

Note: It is important to note that this expenditure need not be incurred either in the government hospital or in a hospital approved by the Chief Commissioner.

- (vii) Any expenditure incurred by the employer on the following:
 - (a) medical treatment of the employee or any member of the family of such employee outside India;
 - (b) travel and stay abroad of the employee or any member of the family of such employee for medical treatment;
 - (c) travel and stay abroad of one attendant who accompanies the patient in connection with such treatment.

Conditions:

1. The perquisite element in respect of expenditure on medical treatment and stay abroad will be exempt only to the extent permitted by the RBI.

2. The expenses in respect of traveling of the patient and the attendant will be exempt if the employee's gross total income as computed before including the said expenditure does not exceed ₹ 2 lakh.

Note: For this purpose, family means spouse and children of the individual. Children may be dependent or independent, married or unmarried. It also includes parents, brothers and sisters of the individual if they are wholly or mainly dependent upon him.

Illustration 10

Compute the taxable value of the perquisite in respect of medical facilities received by Mr. G from his employer during the P.Y. 2014-15:

Medical premium paid for insuring health of Mr. G	₹	7,000
Treatment of Mr. G by his family doctor	₹	5,000
Treatment of Mrs. G in a Government hospital	₹	25,000
Treatment of Mr. G's grandfather in a private clinic	₹	12,000
Treatment of Mr. G's mother (68 years and dependant) by family doctor	₹	8,000
Treatment of Mr. G's sister (dependant) in a nursing home	₹	3,000
Treatment of Mr. G's brother (independent)	₹	6,000
Treatment of Mr. G's father (75 years and dependant) abroad	₹	50,000
Expenses of staying abroad of the patient and	₹	30,000
Limit specified by RBI	₹	75,000

Solution

Computation of taxable value of perquisite in the hands of Mr. G

Particulars	₹	₹
Treatment of Mrs. G in a Government hospital		-
Treatment of Mr. G's father (75 years and dependant) abroad	50,000	
Expenses of staying abroad of the patient and attendant	30,000	
	80,000	
Less : Exempt up to limit specified by RBI	75,000	5,000
Medical premium paid for insuring health of Mr. G		-
Treatment of Mr. G by his family doctor	5,000	
Treatment of Mr. G's mother (dependant) by family doctor	8,000	
Treatment of Mr. G's sister (dependant) in a nursing home	3,000	
	16,000	
Less: Exempt upto ₹ 15,000	15,000	1,000
Add: Treatment of Mr. G's grandfather in a private clinic		12,000
Add: Treatment of Mr. G's brother (independent)		6,000
Taxable value of perquisite		24,000

Note: Grandfather and independent brother are not included within the meaning of family of Mr. G.

(11) Payment of premium on personal accident insurance policies - If an employer takes personal accident insurance policies on the lives of employees and pays the insurance premium, no immediate benefit would become payable and benefit will accrue at a future date only if certain events take place.

Moreover, the employers would be taking such policy in their business interest only, so as to indemnify themselves from payment of any compensation. Therefore, the premium so paid will not constitute a taxable perquisite in the employees' hands [*CIT vs. Lala Shri Dhar* [1972] 84 ITR 19 (Del.)].

1.21 Deductions from Salary

The income chargeable under the head 'Salaries' is computed after making the following deductions:

- (1) Entertainment allowance [Section 16(ii)]
- (2) Professional tax [Section 16(iii)]

(1) Entertainment allowance - Entertainment allowance received is fully taxable and is first to be included in the salary and thereafter the following deduction is to be made:

However deduction in respect of entertainment allowance is available in case of Government employees. The amount of deduction will be lower of:

- (i) One-fifth of his basic salary or
- (ii) ₹ 5,000 or
- (iii) Entertainment allowance received.

Deduction is permissible even if the amount received as entertainment allowance is not proved to have been spent - *CIT vs. Kamal Devi* [1971] 81 ITR 773 (Delhi).

Amount actually spent by the employee towards entertainment out of the entertainment allowance received by him is not a relevant consideration at all.

(2) Professional tax on employment - Professional tax or taxes on employment levied by a State under Article 276 of the Constitution is allowed as deduction only when it is actually paid by the employee during the previous year.

If professional tax is reimbursed or directly paid by the employer on behalf of the employee, the amount so paid is first included as salary income and then allowed as a deduction under section 16.

Illustration 11

Mr. Goyal receives the following emoluments during the previous year ending 31.03.2015.

Basic pay *₹ 40,000*

<i>Dearness Allowance</i>	<i>₹ 15,000</i>
<i>Commission</i>	<i>₹ 10,000</i>
<i>Entertainment allowance</i>	<i>₹ 4,000</i>
<i>Medical expenses reimbursed</i>	<i>₹ 25,000</i>
<i>Professional tax paid</i>	<i>₹ 3,000 (₹ 2,000 was paid by his employer)</i>

Mr. Goyal contributes ₹ 5,000 towards recognized provident fund. He has no other income. Determine the income from salary for A.Y.2015-16, if Mr. Goyal is a State Government employee.

Solution

Computation of salary of Mr. Goyal for the A.Y. 2015-16

Particulars	₹	₹
Basic Salary		40,000
Dearness Allowance		15,000
Commission		10,000
Entertainment Allowance received		4,000
Employee's contribution to RPF [Note]		-
Medical expenses reimbursed	25,000	
Less: Exempt medical expenses	15,000	10,000
Professional tax paid by the employer		2,000
Gross Salary		81,000
Less: Deductions under section 16		
- under section 16(ii) Entertainment allowance being lower of :		
(a) Allowance received	4,000	
(b) One fifth of basic salary [$1/5 \times 40,000$]	8,000	
(c) Statutory amount	5,000	4,000
- under section 16(iii) Professional tax paid		3,000
Income from Salary		74,000

Note: Employee's contribution to RPF is not taxable. It is eligible for deduction under section 80C.

1.22 Deduction under Section 80C

Under the provisions of section 80C, an assessee will be entitled to a deduction from gross total income of the amount invested in LIC policies, provident funds, payment of tuition fees,

repayment of housing loans, etc. subject to a maximum of ₹ 1,50,000.

Students may refer to **Chapter 7** on 'Deductions from Gross Total Income' for a detailed discussion.

1.23 Relief under section 89

(1) Where by reason of any portion of an assessee's salary being paid in arrears or in advance or by reason of his having received in any one financial year, salary for more than twelve months or a payment of profit in lieu of salary under section 17(3), his income is assessed at a rate higher than that at which it would otherwise have been assessed, the Assessing Officer shall, on an application made to him in this behalf, grant such relief as prescribed. The procedure for computing the relief is given in Rule 21A.

(2) Similar tax relief is extended to assessee who receive arrears of family pension as defined in the *Explanation* to clause (iia) of section 57. For the purpose of clause (iia) of section 57, "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.

(3) No relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or a scheme of voluntary separation (in the case of a public sector company), if exemption under section 10(10C) in respect of such compensation received on voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee in respect of the same assessment year or any other assessment year.

Illustration 12

In the case of Mr. Hari, who turned 62 years on 28.3.2015, you are informed that the salary for the previous year 2014-15 is ₹ 10,20,000 and arrears of salary received is ₹ 3,45,000. Further, you are given the following details relating to the earlier years to which the arrears of salary received is attributable to:

<i>Previous year</i>	<i>Taxable Salary</i>	<i>Arrears now received (₹)</i>
2010 – 2011	7,10,000	1,03,000
2011 – 2012	8,25,000	1,17,000
2012 – 2013	9,50,000	1,25,000

Compute the relief available under section 89 and the tax payable for the A.Y. 2015-16.

Note : Rates of Taxes:

Assessment Year	Slab rates of income-tax			
	For resident individuals of the age of 60 years or more at any time during the previous year		For other resident individuals	
	Slabs	Rate	Slabs	Rate
2011-12	Upto ₹ 2,40,000	Nil	Upto ₹ 1,60,000	Nil
	₹ 2,40,000 - ₹ 5,00,000	10%	₹ 1,60,000 - ₹ 5,00,000	10%
	₹ 5,00,000 - ₹ 8,00,000	20%	₹ 5,00,000 - ₹ 8,00,000	20%
	Above ₹ 8,00,000	30%	Above ₹ 8,00,000	30%
2012-13	Upto ₹ 2,50,000	Nil	Upto ₹ 1,80,000	Nil
	₹ 2,50,000 - ₹ 5,00,000	10%	₹ 1,80,000 - ₹ 5,00,000	10%
	₹ 5,00,000 - ₹ 8,00,000	20%	₹ 5,00,000 - ₹ 8,00,000	20%
	Above ₹ 8,00,000	30%	Above ₹ 8,00,000	30%
2013-14	Upto ₹ 2,50,000	Nil	Upto ₹ 2,00,000	Nil
	₹ 2,50,000 - ₹ 5,00,000	10%	₹ 2,00,000 - ₹ 5,00,000	10%
	₹ 5,00,000 - ₹ 10,00,000	20%	₹ 5,00,000 - ₹ 10,00,000	20%
	Above ₹ 10,00,000	30%	Above ₹ 10,00,000	30%

Note – Education cess@2% and secondary and higher education cess@1% is attracted on the income-tax for all the years.

Solution

Computation of tax payable by Mr. Hari for the A.Y 2015-16

Particulars	Incl. arrears of salary	Excl. arrears of salary
Current year salary	10,20,000	10,20,000
Add: Arrears of salary	3,45,000	
Taxable Salary	<u>13,65,000</u>	<u>10,20,000</u>
Income-tax thereon	2,29,500	1,26,000
Add : Education cess @2% plus secondary and higher education cess @1%	<u>6,885</u>	<u>3,780</u>
Total payable	<u>2,36,385</u>	<u>1,29,780</u>

Computation of tax payable on arrears of salary if charged to tax in the respective assessment years

Particulars	A.Y. 2011-12		A.Y. 2012-13		A.Y. 2013-14	
	Incl. arrears	Excl. arrears	Incl. arrears	Excl. arrears	Incl. arrears	Excl. arrears
Taxable salary	7,10,000	7,10,000	8,25,000	8,25,000	9,50,000	9,50,000
Add: Arrears of salary	<u>1,03,000</u>	<u>---</u>	<u>1,17,000</u>	<u>---</u>	<u>1,25,000</u>	<u>---</u>
Taxable salary	<u>8,13,000</u>	<u>7,10,000</u>	<u>9,42,000</u>	<u>8,25,000</u>	<u>10,75,000</u>	<u>9,50,000</u>
Tax on the above	97,900	76,000	1,34,600	99,500	1,47,500	1,15,000
Add: Cess@3%	<u>2,937</u>	<u>2,280</u>	<u>4,038</u>	<u>2,985</u>	<u>4,425</u>	<u>3,450</u>
Tax payable	<u>1,00,837</u>	<u>78,280</u>	<u>1,38,638</u>	<u>1,02,485</u>	<u>1,51,925</u>	<u>1,18,450</u>

Computation of relief under section 89

	Particulars	₹	₹
i	Tax payable in A.Y. 2015-16 on arrears :		
	Tax on income including arrears	2,36,385	
	Less : Tax on income excluding arrears	<u>1,29,780</u>	1,06,605
ii	Tax payable in respective years on arrears :		
	Tax on income including arrears (₹ 1,00,837 + ₹ 1,38,638 + ₹ 1,51,925)	3,91,400	
	Less: Tax on income excluding arrears (₹ 78,280 + ₹ 1,02,485 + ₹ 1,18,450)	<u>2,99,215</u>	<u>92,185</u>
	Relief under section 89 - difference between tax on arrears in A.Y 2015-16 and tax on arrears in the respective years		<u>14,420</u>

Tax payable for A.Y 2015-16 after relief under section 89

Particulars	₹
Income-tax payable on total income including arrears of salary	2,36,385
Less : Relief under section 89 as computed above	<u>14,420</u>
Tax payable after claiming relief	<u>2,21,965</u>

Illustration 13

Mr. X is employed with AB Ltd. on a monthly salary of ₹ 25,000 per month and an entertainment allowance and commission of ₹ 1,000 p.m. each. The company provides him

with the following benefits:

1. A company owned accommodation is provided to him in Delhi. Furniture costing ₹ 2,40,000 was provided on 1.8.2014.
2. A personal loan of ₹ 5,00,000 on 1.7.2014 on which it charges interest @ 6.75% p.a. The entire loan is still outstanding. (Assume SBI rate of interest to be 12.75% p.a.)
3. His son is allowed to use a motor cycle belonging to the company. The company had purchased this motor cycle for ₹ 60,000 on 1.5.2011. The motor cycle was finally sold to him on 1.8.2014 for ₹ 30,000.
4. Professional tax paid by Mr. X is ₹ 2,000.

Compute the income from salary of Mr. X for the A.Y.2015-16.

Solution

Computation of Income from Salary of Mr. X for the A.Y.2015-16

Particulars	₹	₹
Basic salary [₹ 25,000 × 12]		3,00,000
Commission [₹ 1,000 × 12]		12,000
Entertainment allowance [₹ 1,000 × 12]		12,000
Rent free accommodation [Note 1]	48,600	
Add : Value of furniture [₹ 2,40,000 × 10% p.a. for 8 months]	16,000	64,600
Interest on personal loan [Note 2]		22,500
Use of motor cycle [₹ 60,000 × 10% p.a. for 4 months]		2,000
Transfer of motor cycle [Note 3]		12,000
Gross Salary		4,25,100
Less : Deduction under section 16(iii)		
Professional tax paid		2,000
Income from Salary		4,23,100

Note 1: Value of rent free unfurnished accommodation

$$= 15\% \text{ of salary for the relevant period}$$

$$= 15\% \text{ of } (\text{₹ } 3,00,000 + \text{₹ } 12,000 + \text{₹ } 12,000) = \text{₹ } 48,600$$

Note 2: Value of perquisite for interest on personal loan

$$= [\text{₹ } 5,00,000 \times (12.75\% - 6.75\%) \text{ for 9 months}] = \text{₹ } 22,500$$

Note 3: Depreciated value of the motor cycle

$$= \text{Original cost} - \text{Depreciation @ } 10\% \text{ p.a. for 3 completed years.}$$

$$= \text{₹ } 60,000 - (\text{₹ } 60,000 \times 10\% \text{ p.a.} \times 3 \text{ years}) = \text{₹ } 42,000.$$

$$\text{Perquisite} = \text{₹ } 42,000 - \text{₹ } 30,000 = \text{₹ } 12,000.$$

UNIT – 2 : INCOME FROM HOUSE PROPERTY**Learning Objectives**

After studying this unit, you would be able to understand –

- ◆ when income is chargeable under the head “Income from house property”
- ◆ what are the conditions to be satisfied for income to be chargeable under this head.
- ◆ what is composite rent and what is the tax treatment for the same.
- ◆ how to determine annual value of different categories of house property
- ◆ the tax treatment for unrealized rent
- ◆ what are the admissible deductions from annual value
- ◆ what are the inadmissible deductions while computing income from house property
- ◆ how to compute income from house property for different categories of house property
- ◆ what is the tax treatment on recovery of unrealized rent and arrears of rent
- ◆ what is meant by co-ownership and what is the tax treatment in respect of the same.
- ◆ who are the deemed owners of house property
- ◆ the cases where income from house property is exempt from tax.

2.1 Chargeability [Section 22]

(i) The process of computation of income under the head “Income from house property” starts with the determination of annual value of the property. The concept of annual value and the method of determination is laid down in section 23.

(ii) The annual value of any property comprising of building or land appurtenant thereto, of which the assessee is the owner, is chargeable to tax under the head “Income from house property”.

2.2 Conditions for Chargeability

(i) **Property should consist of any building or land appurtenant thereto.**

- (a) Buildings include not only residential buildings, but also factory buildings, offices, shops, godowns and other commercial premises.
- (b) Land appurtenant means land connected with the building like garden, garage etc.
- (c) Income from letting out of vacant land is, however, taxable under the head “Income from other sources”.

(ii) **Assessee must be the owner of the property**

- (a) Owner is the person who is entitled to receive income from the property in his own right.

- (b) The requirement of registration of the sale deed is not warranted.
 - (c) Ownership includes both free-hold and lease-hold rights.
 - (d) Ownership includes deemed ownership (discussed later in para 2.12)
 - (e) The person who owns the building need not also be the owner of the land upon which it stands.
 - (f) The assessee must be the owner of the house property during the previous year. It is not material whether he is the owner in the assessment year.
 - (g) If the title of the ownership of the property is under dispute in a court of law, the decision as to who will be the owner chargeable to income-tax under section 22 will be of the Income-tax Department till the court gives its decision to the suit filed in respect of such property.
- (iii) The property may be used for any purpose, but it should not be used by the owner for the purpose of any business or profession carried on by him, the profit of which is chargeable to tax.
- (iv) **Property held as stock-in-trade etc.:** Annual value of house property will be charged under the head "Income from house property" in the following cases also –
- (a) Where it is held by the assessee as stock-in-trade of a business;
 - (b) Where the assessee is engaged in the business of letting out of property on rent;

Exceptions

(a) Letting out is supplementary to the main business

- (i) Where the property is let out with the object of carrying on the business of the assessee in an efficient manner, then the rental income is taxable as business income, provided letting is not the main business but it is supplementary to the main business.
- (ii) In such a case, the letting out of the property is supplementary to the main business of the assessee and deductions/allowances have to be calculated as relating to profits/gains of business and not relating to house property.

(b) Letting out of building along with other facilities

- (i) Where income is derived from letting out of building along with other facilities like furniture, the income cannot be said to be derived from mere ownership of house property but also because of facilities and services rendered and hence assessable as income from business.
- (ii) Where a commercial property is let out along with machinery e.g. a cotton mill including the building and the two lettings are inseparable, the income will either be assessed as business income or as income from other sources, as the case may be.

2.3 Composite Rent

(i) **Meaning of composite rent :** The owner of a property may sometimes receive rent in respect of building as well as –

- (1) other assets like say, furniture, plant and machinery.

- (2) for different services provided in the building, for eg. –
 - (a) Lifts;
 - (b) Security;
 - (c) Power backup;

The amount so received is known as “composite rent”.

(ii) Tax treatment of composite rent

- (1) Where composite rent includes rent of building and charges for different services (lifts, security etc.), the composite rent is has to be split up in the following manner –
 - (a) the sum attributable to use of property is to be assessed under section 22 as income from house property;
 - (b) the sum attributable to use of services is to charged to tax under the head “Profits and gains of business or profession” or under the head “Income from other sources”.
- (2) Where composite rent is received from letting out of building and other assets (like furniture) and the two lettings are not separable –
 - (a) If the letting out of building and other assets are not separable i.e. the other party does not accept letting out of buildings without other assets, then the rent is taxable either as business income or income from other sources;
 - (b) This is applicable even if sum receivable for the two lettings is fixed separately.
- (3) Where composite rent is received from letting out of buildings and other assets and the two lettings are separable –
 - (a) If building is let out along with other assets, but the two lettings are separable i.e. letting out of one is acceptable to the other party without letting out of the other, then income from letting out of building is taxable under “Income from house property”;
 - (b) Income from letting out of other assets is taxable as business income or income from other sources;
 - (c) This is applicable even if a composite rent is received by the assessee from his tenant for the two lettings.

2.4 Income from House Property Situated Outside India

- (i) In case of a resident in India (resident and ordinarily resident in case of individuals and HUF), income from property situated outside India is taxable, whether such income is brought into India or not.
- (ii) In case of a non-resident or resident but not ordinarily resident in India, income from a property situated outside India is taxable only if it is received in India.

2.5 Determination of Annual Value [Section 23]

This involves three steps:

Step 1 - Determination of Gross Annual Value (GAV).

Step 2 – From the gross annual value computed in step 1, deduct municipal tax paid by the owner during the previous year.

Step 3 – The balance will be the Net Annual Value (NAV), which as per the Income-tax Act, 1961 is the annual value.

(i) Determination of annual value for different types of house properties

(1) Where the property is let out throughout the previous year [Section 23(1)(a)/(b)]

Where the property is let out for the whole year, then the GAV would be the higher of -

- (a) Expected Rent (ER) and
- (b) Actual rent received or receivable during the year

- ◆ The Expected Rent (ER) is the higher of fair rent (FR) and municipal value (MV), but restricted to standard rent (SR).
For example, let us say the higher of FR and MV is X. Then $ER = SR$, if $X > SR$. However, if $X < SR$, $ER = X$.
- ◆ Expected Rent (ER) as per section 23(1)(a) cannot exceed standard rent (SR) but it can be lower than standard rent, in a case where standard rent is more than the higher of MV and FR.
- ◆ Municipal value is the value determined by the municipal authorities for levying municipal taxes on house property.
- ◆ Fair rent means rent which similar property in the same locality would fetch.
- ◆ The standard rent (SR) is fixed by the Rent Control Act.
- ◆ From the GAV computed above, municipal taxes paid by the owner during the previous year is to be deducted to arrive at the NAV.

Illustration 1

Jayashree owns five houses in Chennai, all of which are let-out. Compute the GAV of each house from the information given below –

Particulars	House I	House II	House III	House IV	House V
Municipal Value	80,000	55,000	65,000	24,000	75,000
Fair Rent	90,000	60,000	65,000	25,000	80,000
Standard Rent	N.A.	75,000	58,000	N.A.	78,000
Actual rent received/ receivable	72,000	72,000	60,000	30,000	72,000

Solution

GAV	90,000	72,000	60,000	30,000	78,000
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(2) Where let out property is vacant for part of the year [Section 23(1)(c)]: Where let out property is vacant for part of the year and owing to vacancy, the actual rent is lower than the ER, then the actual rent received or receivable will be the GAV of the property.

(3) In case of self-occupied property or unoccupied property [Section 23(2)]: (a) Where the property is self-occupied for own residence or unoccupied throughout the previous year, its Annual Value will be Nil, provided no other benefit is derived by the owner from such property.

(b) The benefit of exemption of one self-occupied house is available only to an individual/HUF.

(c) The expression "Unoccupied property" refers to a property which cannot be occupied by the owner by reason of his employment, business or profession at a different place and he resides at such other place in a building not belonging to him.

(d) No deduction for municipal taxes is allowed in respect of such property.

(4) Where a house property is let-out for part of the year and self-occupied for part of the year [Section 23(3)]: (a) If a single unit of a property is self-occupied for part of the year and let-out for the remaining part of the year, then the ER for the whole year shall be taken into account for determining the GAV.

(b) The ER for the whole year shall be compared with the actual rent for the let out period and whichever is higher shall be adopted as the GAV.

(c) However, property taxes for the whole year is allowed as deduction provided it is paid by the owner during the previous year.

(5) In case of deemed to be let out property [Section 23(4)]: (a) Where the assessee owns more than one property for self-occupation, then the income from any one such property, at the option of the assessee, shall be computed under the self-occupied property category and its annual value will be nil. The other self-occupied/unoccupied properties shall be treated as "deemed let out properties".

(b) This option can be changed year after year in a manner beneficial to the assessee.

(c) In case of deemed let-out property, the ER shall be taken as the GAV.

(d) The question of considering actual rent received/receivable does not arise. Consequently, no adjustment is necessary on account of property remaining vacant or unrealized rent.

(e) Municipal taxes actually paid by the owner during the previous year can be claimed as deduction.

(6) In case of a house property, a portion let out and a portion self-occupied

(a) Income from any portion or part of a property which is let out shall be computed

separately under the "let out property" category and the other portion or part which is self-occupied shall be computed under the "self-occupied property" category.

(b) There is no need to treat the whole property as a single unit for computation of income from house property.

(c) Municipal valuation/fair rent/standard rent, if not given separately, shall be apportioned between the let-out portion and self-occupied portion either on plinth area or built-up floor space or on such other reasonable basis.

(d) Property taxes, if given on a consolidated basis can be bifurcated as attributable to each portion or floor on a reasonable basis.

Notional income instead of real income

Thus, under this head of income, there are circumstances where notional income is charged to tax instead of real income. For example –

- Where the assessee owns more than one house property for the purpose of self-occupation, the annual value of any one of those properties, at the option of the assessee, will be nil and the other properties are deemed to be let-out and income has to be computed on a notional basis by taking the Expected Rent (ER) as the GAV.
- In the case of let-out property also, if the Expected Rent (ER) exceeds the actual rent, the ER is taken as the GAV.

(ii) Treatment of unrealised rent [Explanation to section 23(1)]

(1) The Actual rent received/receivable should not include any amount of rent which is not capable of being realised.

(2) However the conditions prescribed in Rule 4 should be satisfied. They are –

- (a) the tenancy is *bona fide*;
- (b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;
- (c) the defaulting tenant is not in occupation of any other property of the assessee;
- (d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

(iii) Property taxes (Municipal taxes)

(1) Property taxes are allowable as deduction from the GAV subject to the following two conditions:

- (a) It should be borne by the assessee (owner); and
- (b) It should be actually paid during the previous year.

(2) If property taxes levied by a local authority for a particular previous year is not paid during that year, no deduction shall be allowed in the computation of income from house property for that year.

(3) However, if in any subsequent year, the arrears are paid, then, the amount so paid is allowed as deduction in computation of income from house property for that year.

(4) Thus, we find that irrespective of the previous year in which the liability to pay such taxes arise according to the method of accounting regularly employed by the owner, the deduction in respect of such taxes will be allowed only in the year of actual payment.

(5) In case of property situated outside India, taxes levied by local authority of the country in which the property is situated is deductible [*CIT v. R. Venugopala Reddiar (1965) 58 ITR 439 (Mad)*].

Illustration 2

Rajesh, a British national, is a resident and ordinarily resident in India during the P.Y.2014-15. He owns a house in London, which he has let out at £ 10,000 p.m. The municipal taxes paid to the Municipal Corporation of London is £ 8,000 during the P.Y.2014-15. The value of one £ in Indian rupee to be taken at ₹ 82.50. Compute Rajesh's taxable income for the A.Y. 2015-16.

Solution

For the P.Y.2014-15, Mr. Rajesh, a British national, is resident and ordinarily resident in India. Therefore, income received by him by way of rent of the house property located in London is to be included in the total income in India. Municipal taxes paid in London is to be allowed as deduction from the gross annual value.

Computation of Income from house property of Mr. Rajesh for A.Y.2015-16

Particulars	₹
Gross Annual Value ($£ 10,000 \times 12 \times 82.50$)	99,00,000
Less: Municipal taxes paid ($£ 8,000 \times 82.50$)	6,60,000
Net Annual Value (NAV)	92,40,000
Less: Deduction under section 24	
(a) 30% of NAV = 30% of ₹ 92,40,000	27,72,000
Income from house property	64,68,000

2.6 Deductions from Annual Value [Section 24]

(i) There are two deductions from annual value. They are –

(1) 30% of NAV; and

(2) interest on borrowed capital

(1) **30% of NAV is allowed as deduction under section 24(a)**

(a) This is a flat deduction and is allowed irrespective of the actual expenditure incurred.

- (b) In case of self-occupied property where the annual value is nil, the assessee will not be entitled to deduction of 30%, as the annual value itself is nil.
- (2) Interest on borrowed capital is allowed as deduction under section 24(b)**
- (a) Interest payable on loans borrowed for the purpose of acquisition, construction, repairs, renewal or reconstruction can be claimed as deduction.
- (b) Interest payable on a fresh loan taken to repay the original loan raised earlier for the aforesaid purposes is also admissible as a deduction.
- (c) Interest relating to the year of completion of construction can be fully claimed in that year irrespective of the date of completion.
- (d) Interest payable on borrowed capital for the period prior to the previous year in which the property has been acquired or constructed, can be claimed as deduction over a period of 5 years in equal annual installments commencing from the year of acquisition or completion of construction.

Illustration 3

Arvind had taken a loan of ₹ 5,00,000 for construction of property on 1.10.2013. Interest was payable @ 10% p.a. The construction was completed on 30.6.2014. No principal repayment has been made up to 31.3.2015. Compute the interest allowable as deduction under section 24 for the A.Y.2015-16.

Solution

Interest for the year (1.4.2014 to 31.3.2015) = 10% of ₹ 5,00,000 = ₹ 50,000

Pre-construction interest = 10% of ₹ 5,00,000 for 6 months (from 1.10.2013 to 31.3.2014) = ₹ 25,000

Pre-construction interest to be allowed in 5 equal annual installments of ₹ 5,000 from the year of completion of construction i.e. in this case, P.Y.2014-15.

Therefore, total interest deduction under section 24 = 50,000 + 5,000 = ₹ 55,000.

(ii) Deduction in respect of one self-occupied property where annual value is nil

- (1) In this case, the assessee will be allowed a deduction on account of interest (including 1/5th of the accumulated interest of pre-construction period) as under –

(a)	Where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital before 1.4.99.	Actual interest payable subject to maximum of ₹ 30,000.
(b)	Where the property is acquired or constructed with capital borrowed on or after 1.4.99 and such acquisition or construction is completed within 3 years from the end of the financial year in which the capital was borrowed.	Actual interest payable subject to maximum of ₹ 2,00,000, if certificate mentioned in (2) below is obtained.

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(c)	Where the property is repaired, renewed or reconstructed with capital borrowed on or after 1.4.99.	Actual interest payable subject to a maximum of ₹ 30,000.
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(2) For the purpose of claiming deduction of ₹ 2,00,000 as per 1(b) in the table given above, the assessee should furnish a certificate from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property.

(3) The ceiling prescribed for one self-occupied property as above in respect of interest on loan borrowed does not apply to a deemed let-out property.

(4) Deduction under section 24(b) for interest is available on accrual basis. Therefore interest accrued but not paid during the year can also be claimed as deduction.

(5) Where a buyer enters into an arrangement with a seller to pay the sale price in installments along with interest due thereon, the seller becomes the lender in relation to the unpaid purchase price and the buyer becomes the borrower. In such a case, unpaid purchase price can be treated as capital borrowed for acquiring property and interest paid thereon can be allowed as deduction under section 24.

(6) Interest on unpaid interest is not deductible.

2.7 Computation of "Income from house property" for different categories of property

(i) Property let out throughout the previous year

PARTICULARS		Amount
Computation of GAV		
Step 1	Compute ER ER = Higher of MV and FR, but restricted to SR	
Step 2	Compute Actual rent received/receivable Actual rent received/receivable less unrealized rent as per Rule 4	
Step 3	Compare ER and Actual rent received/receivable	
Step 4	GAV is the higher of ER and Actual rent received/receivable	
Gross Annual Value (GAV)		A
Less:	Municipal taxes (paid by the owner during the previous year)	B
Net Annual Value (NAV) = (A-B)		C
Less:	Deductions u/s 24 (a) 30% of NAV	D

(b) Interest on borrowed capital (actual without any ceiling limit)	E	
Income from house property (C-D-E)		F

Illustration 4

Anirudh has a property whose municipal valuation is ₹ 1,30,000 p.a. The fair rent is ₹ 1,10,000 p.a. and the standard rent fixed by the Rent Control Act is ₹ 1,20,000 p.a. The property was let out for a rent of ₹ 11,000 p.m. throughout the previous year. Unrealised rent was ₹ 11,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @10% of municipal valuation. Interest on borrowed capital was ₹ 40,000 for the year. Compute the income from house property of Anirudh for A.Y.2015-16.

Solution**Computation of Income from house property of Mr. Anirudh for A.Y. 2015-16**

Particulars		Amount in ₹	
Computation of GAV			
Step 1	Compute ER ER = Higher of MV of ₹ 1,30,000 p.a. and FR of ₹ 1,10,000 p.a., but restricted to SR of ₹ 1,20,000 p.a.	1,20,000	
Step 2	Compute actual rent received/receivable Actual rent received/receivable less unrealized rent as per Rule 4 = ₹ 1,32,000 - ₹ 11,000	1,21,000	
Step 3	Compare ER of ₹ 1,20,000 and Actual rent received/receivable of ₹ 1,21,000.		
Step 4	GAV is the higher of ER and Actual rent received/receivable	1,21,000	
Gross Annual Value (GAV)			1,21,000
Less:	Municipal taxes (paid by the owner during the previous year) = 10% of ₹ 1,30,000		13,000
Net Annual Value (NAV)			1,08,000
Less:	Deductions under section 24		
	(a) 30% of NAV	32,400	
	(b) Interest on borrowed capital (actual without any ceiling limit)	40,000	72,400
Income from house property			35,600

(ii) Let out property vacant for part of the year

Particulars		Amount
Computation of GAV		
Step 1	Compute ER ER = Higher of MV and FR, but restricted to SR	
Step 2	Compute Actual rent received/receivable Actual rent received/receivable for let out period less unrealized rent as per Rule 4	
Step 3	Compare ER and Actual rent received/receivable	
Step 4	If Actual rent is lower than ER owing to vacancy, then Actual rent is the GAV. If Actual rent is lower than ER due to other reasons, then ER is the GAV. However, in spite of vacancy, if the actual rent is higher than the ER, then Actual rent is the GAV.	
Gross Annual Value (GAV)		A
Less:	Municipal taxes (paid by the owner during the previous year)	B
Net Annual Value (NAV) = (A-B)		C
Less:	Deductions under section 24	
	(a) 30% of NAV	D
	(b) Interest on borrowed capital (actual without any ceiling limit)	E
Income from house property (C-D-E)		F

Illustration 5

Ganesh has a property whose municipal valuation is ₹ 2,50,000 p.a. The fair rent is ₹ 2,00,000 p.a. and the standard rent fixed by the Rent Control Act is ₹ 2,10,000 p.a. The property was let out for a rent of ₹ 20,000 p.m. However, the tenant vacated the property on 31.1.2015. Unrealised rent was ₹ 20,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @8% of municipal valuation. Interest on borrowed capital was ₹ 65,000 for the year. Compute the income from house property of Ganesh for A.Y.2015-16.

Solution

Computation of income from house property of Ganesh for A.Y.2015-16

Particulars		Amount in ₹	
Computation of GAV			
Step 1	Compute ER		

Step 2	ER = Higher of MV of ₹ 2,50,000 p.a. and FR of ₹ 2,00,000 p.a., but restricted to SR of ₹ 2,10,000 p.a.	2,10,000	
Step 3	Compute Actual rent received/receivable		
Step 4	Actual rent received/receivable for let out period less unrealized rent as per Rule 4 = ₹ 2,00,000 - ₹ 20,000	1,80,000	
Step 3	Compare ER and Actual rent received/receivable		
Step 4	In this case the actual rent of ₹ 1,80,000 is lower than ER of ₹ 2,10,000 owing to vacancy, since, had the property not been vacant the actual rent would have been ₹ 2,20,000 (₹ 1,80,000 + ₹ 40,000). Therefore, actual rent is the GAV.	1,80,000	
	Gross Annual Value (GAV)		1,80,000
Less:	Municipal taxes (paid by the owner during the previous year) = 8% of ₹ 2,50,000		20,000
	Net Annual Value (NAV)		1,60,000
Less:	Deductions under section 24		
	(a) 30% of NAV = 30% of ₹ 1,60,000	48,000	
	(b) Interest on borrowed capital (actual without any ceiling limit)	65,000	1,13,000
	Income from house property		47,000

(iii) Self-occupied property or Unoccupied property

Particulars		Amount
Annual value under section 23(2)		Nil
Less:	Deduction under section 24	
	Interest on borrowed capital	E
	Interest on loan taken for acquisition or construction of house on or after 1.4.99 and same was completed within 3 years from the end of the financial year in which capital was borrowed, interest paid or payable subject to a maximum of ₹ 2,00,000 (including apportioned pre-construction interest).	
	(ii) In case of loan for acquisition or construction taken prior to 1.4.99 or loan taken for repair, renovation or reconstruction at any point of time, interest paid or payable subject to a maximum of ₹ 30,000.	
Income from house property		-E

Illustration 6

Poorna has one house property at Indira Nagar in Bangalore. She stays with her family in the house. The rent of similar property in the neighbourhood is ₹ 25,000 p.m. The municipal valuation is ₹ 23,000 p.m. Municipal taxes paid is ₹ 8,000. The house was constructed in the year 2008 with a loan of ₹ 20,00,000 taken from SBI Housing Finance Ltd. The construction was completed on 30.11.2010. The accumulated interest up to 31.3.2010 is ₹ 1,50,000. During the previous year 2014-15, Poorna paid ₹ 2,40,000 which included ₹ 1,80,000 as interest. Compute Poorna's income from house property for A.Y. 2015-16.

Solution**Computation of income from house property of Smt. Poorna for A.Y.2015-16**

Particulars	Amount ₹
Annual Value of one house used for self-occupation under section 23(2)	Nil
Less: Deduction under section 24	
Interest on borrowed capital	
Interest on loan was taken for construction of house on or after 1.4.99 and same was completed within 3 years - interest paid or payable subject to a maximum of ₹ 2,00,000 (including apportioned pre-construction interest) will be allowed as deduction.	2,00,000
In this case the total interest is ₹ 1,80,000 + ₹ 30,000 (Being 1/5 th of ₹ 1,50,000) = ₹ 2,10,000. However, the interest deduction is restricted to ₹ 2,00,000.	
Loss from house property	-2,00,000

(iv) House property let-out for part of the year and self-occupied for part of the year

Particulars	Amount
Computation of GAV	
Step 1 Compute ER for the whole year ER = Higher of MV and FR, but restricted to SR	
Step 2 Compute Actual rent received/receivable Actual rent received/receivable for the period let out less unrealized rent as per Rule 4	
Step 3 Compare ER for the whole year with the actual rent received/receivable for the let out period	
Step 4 GAV is the higher of ER computed for the whole year and Actual rent received/receivable computed for the let-out period.	
Gross Annual Value (GAV)	A

Less:	Municipal taxes (paid by the owner during the previous year)	B
Net Annual Value (NAV) = (A-B)		C
Less:	Deductions under section 24	
	(a) 30% of NAV	D
	(b) Interest on borrowed capital (actual without any ceiling limit)	E
Income from house property (C-D-E)		F

Illustration 7

Smt. Rajalakshmi owns a house property at Adyar in Chennai. The municipal value of the property is ₹ 5,00,000, fair rent is ₹ 4,20,000 and standard rent is ₹ 4,80,000. The property was let-out for ₹ 50,000 p.m. up to December 2014. Thereafter, the tenant vacated the property and Smt. Rajalakshmi used the house for self-occupation. Rent for the months of November and December 2014 could not be realised in spite of the owner's efforts. All the conditions prescribed under Rule 4 are satisfied. She paid municipal taxes @12% during the year. She had paid interest of ₹ 25,000 during the year for amount borrowed for repairs for the house property. Compute her income from house property for the A.Y. 2015-16.

Solution

Computation of income from house property of Smt. Rajalakshmi for the A.Y. 2015-16

Particulars		Amount in ₹	
Computation of GAV			
Step 1	Compute ER for the whole year ER = Higher of MV of ₹ 5,00,000 and FR of ₹ 4,20,000, but restricted to SR of ₹ 4,80,000	4,80,000	
Step 2	Compute Actual rent received/receivable Actual rent received/receivable for the period let out less unrealized rent as per Rule 4 = (₹ 50,000×9) - (₹ 50,000 × 2) = ₹ 4,50,000 - ₹ 1,00,000 =	3,50,000	
Step 3	Compare ER for the whole year with the actual rent received/receivable for the let out period i.e. ₹ 4,80,000 and ₹ 3,50,000		
Step 4	GAV is the higher of ER computed for the whole year and Actual rent received/receivable computed for the let-out period.	4,80,000	
Gross Annual Value (GAV)			4,80,000
Less:	Municipal taxes (paid by the owner during the previous year) = 12% of ₹ 5,00,000		60,000
Net Annual Value (NAV)			4,20,000

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Less:	Deductions under section 24		
	(a) 30% of NAV = 30% of ₹ 4,20,000	1,26,000	
	(b) Interest on borrowed capital	25,000	1,51,000
	Income from house property		2,69,000

(v) Deemed to be let out property

Particulars	Amount
Gross Annual Value (GAV)	A
ER is the GAV of house property	
ER = Higher of MV and FR, but restricted to SR	
Less: Municipal taxes (paid by the owner during the previous year)	B
Net Annual Value (NAV) = (A-B)	C
Less: Deductions under section 24	
(a) 30% of NAV	D
(b) Interest on borrowed capital	E
(actual without any ceiling limit)	
Income from house property (C-D-E)	F

Illustration 8

Ganesh has two houses, both of which are self-occupied. The particulars of the houses for the P.Y.2014-15 are as under:

Particulars	House I	House II
Municipal valuation p.a.	1,00,000	1,50,000
Fair rent p.a.	75,000	1,75,000
Standard rent p.a.	90,000	1,60,000
Date of completion	31.3.1999	31.3.2001
Municipal taxes paid during the year	12%	8%
Interest on money borrowed for repair of property during the current year	-	55,000

Compute Ganesh's income from house property for A.Y.2015-16 and suggest which house should be opted by Ganesh to be assessed as self-occupied so that his tax liability is minimum.

Solution

Computation of income from house property of Ganesh for the A.Y. 2015-16

Let us first calculate the income from each house property assuming that they are deemed to be let out.

Particulars	Amount in ₹	
	House I	House II
Gross Annual Value (GAV) ER is the GAV of house property ER = Higher of MV and FR, but restricted to SR	90,000	1,60,000
Less: Municipal taxes (paid by the owner during the previous year)	12,000	12,000
Net Annual Value (NAV)	78,000	1,48,000
Less: Deductions under section 24		
(a) 30% of NAV	23,400	44,400
(b) Interest on borrowed capital	-	55,000
Income from house property	54,600	48,600

OPTION 1 (House I – self-occupied and House II – deemed to be let out)

If House I is opted to be self-occupied, the income from house property shall be –

Particulars	Amount in ₹
House I (Self-occupied)	Nil
House II (Deemed to be let-out)	48,600
Income from house property	48,600

OPTION 2 (House I – deemed to be let out and House II – self-occupied)

If House II is opted to be self-occupied, the income from house property shall be –

Particulars	Amount in ₹
House I (Deemed to be let-out)	54,600
House II (Self-occupied)	-30,000
(interest deduction restricted to ₹ 30,000)	
Income from house property	24,600

Since Option 2 is more beneficial, Ganesh should opt to treat House II as self-occupied and House I as deemed to be let out. His income from house property would be ₹ 24,600 for the A.Y. 2015-16.

(vi) House property, a portion let out and a portion self-occupied**Illustration 9**

Prem owns a house in Madras. During the previous year 2014-15, 2/3rd portion of the house was self-occupied and 1/3rd portion was let out for residential purposes at a rent of ₹ 8,000 p.m. Municipal value of the property is ₹ 3,00,000 p.a., fair rent is ₹ 2,70,000 p.a. and standard rent is ₹ 3,30,000. He paid municipal taxes @10% of municipal value during the

year. A loan of ₹ 25,00,000 was taken by him during the year 2012 for acquiring the property. Interest on loan paid during the previous year 2014-15 was ₹ 1,20,000. Compute Prem's income from house property for the A.Y. 2015-16.

Solution

There are two units of the house. Unit I with 2/3rd area is used by Prem for self-occupation throughout the year and no benefit is derived from that unit, hence it will be treated as self-occupied and its annual value will be Nil. Unit 2 with 1/3rd area is let-out throughout the previous year and its annual value has to be determined as per section 23(1).

Computation of income from house property of Mr. Prem for A.Y.2015-16

Particulars	Amount in ₹	
Unit I (2/3rd area – self-occupied)		
Annual Value		Nil
Less: Deduction under section 24(b) 2/3 rd of ₹ 1,20,000		80,000
Income from Unit I (self-occupied)		-80,000
Unit II (1/3rd area – let out)		
Computation of GAV		
Step I – Compute ER		
ER = Higher of MV and FR, restricted to SR. However, in this case, SR of ₹ 1,10,000 (1/3 rd of ₹ 3,30,000) is more than the higher of MV of ₹ 1,00,000 (1/3 rd of ₹ 3,00,000) and FR of ₹ 90,000 (1/3 rd of ₹ 2,70,000). Hence the higher of MV and FR is the ER. In this case, it is the MV.	1,00,000	
Step 2 – Compute actual rent received/ receivable ₹ 8,000×12 = ₹ 96,000	96,000	
Step 3 – GAV is the higher of ER and actual rent received/receivable i.e. higher of ₹ 1,00,000 and ₹ 96,000	1,00,000	
Gross Annual Value (GAV)		1,00,000
Less: Municipal taxes paid by the owner during the previous year relating to let-out portion 1/3 rd of (10% of ₹ 3,00,000) = ₹ 30,000/3 = ₹ 10,000		10,000
Net Annual Value (NAV)		90,000
Less: Deductions under section 24 (a) 30% of NAV = 30% of ₹ 90,000	27,000	

(b) Interest paid on borrowed capital (relating to let out portion) 1/3 rd of ₹ 1,20,000	40,000	67,000
Income from Unit II (let-out)		23,000
Loss under the head "Income from house property" = ₹ -80,000 + ₹ 23,000 = -57,000		

2.8 Inadmissible deductions [Section 25]

Interest chargeable under this Act which is payable outside India shall not be deducted if –

- (a) tax has not been paid or deducted from such interest and
- (b) there is no person in India who may be treated as an agent under section 163.

2.9 Taxability of recovery of unrealised rent & arrears of rent received

(i) Unrealised rent is deducted from actual rent in determination of annual value under section 23, subject to fulfillment of conditions under Rule 4. Subsequently, when the amount is realized, it gets taxed under section 25AA in the year of receipt.

(ii) If the assessee has increased the rent payable by the tenant and the same has been in dispute and later on the assessee receives the increase in rent as arrears, such arrears is assessable under section 25B.

	Unrealised rent [Section 25AA]	Arrears of rent [Section 25B]
(a)	Taxable in the hands of the assessee whether he is the owner of that property or not.	Taxable in the hands of the assessee whether he is the owner of that property or not.
(b)	Taxable as income of the previous year in which he recovers the unrealized rent.	Taxable as income of the year in which he receives the arrears of rent.
(c)	No deduction shall be allowed.	30% of the amount of arrears shall be allowed as deduction.
(d)	Unrealised rent means the rent which has been deducted from actual rent in any previous year for determining annual value.	Arrears of rent is in respect of rent not charged to income-tax for any previous year.

2.10 Treatment of income from co-owned property [Section 26]

(i) Where property is owned by two or more persons, whose shares are definite and ascertainable, then the income from such property cannot be taxed as income of an AOP.

(ii) The share income of each such co-owner should be determined in accordance with sections 22 to 25 and included in his individual assessment.

(iii) Where the house property owned by co-owners is self occupied by each of the co-owners, the annual value of the property of each co-owner will be Nil and each co-owner shall be entitled to a deduction of ₹ 30,000 / ₹ 2,00,000, as the case may be, under section 24(b) on account of interest on borrowed capital.

(iv) Where the house property owned by co-owners is let out, the income from such property shall be computed as if the property is owned by one owner and thereafter the income so computed shall be apportioned amongst each co-owner as per their specific share.

2.11 Treatment of income from property owned by a partnership firm

(i) Where an immovable property or properties is included in the assets of a firm, the income from such property should be assessed in the hands of the firm only.

(ii) Hence, the property income cannot be assessed as income of the individual partner in respect of his share in the firm.

2.12 Deemed Ownership [Section 27]

As per section 27, the following persons, though not legal owners of a property, are deemed to be the owners for the purposes of section 22 to 26.

(i) **Transfer to a spouse [Section 27(i)]** – In case of transfer of house property by an individual to his or her spouse otherwise than for adequate consideration, the transferor is deemed to be the owner of the transferred property.

Exception – In case of transfer to spouse in connection with an agreement to live apart, the transferor will not be deemed to be the owner. The transferee will be the owner of the house property.

(ii) **Transfer to a minor child [Section 27(ii)]** – In case of transfer of house property by an individual to his or her minor child otherwise than for adequate consideration, the transferor would be deemed to be owner of the house property transferred.

Exception – In case of transfer to a minor married daughter, the transferor is not deemed to be the owner.

Note - Where cash is transferred to spouse/minor child and the transferee acquires property out of such cash, then the transferor shall not be treated as deemed owner of the house property. However, clubbing provisions will be attracted.

(iii) **Holder of an impartible estate [Section 27(ii)]** – The impartible estate is a property which is not legally divisible. The holder of an impartible estate shall be deemed to be the individual owner of all properties comprised in the estate.

After enactment of the Hindu Succession Act, 1956, all the properties comprised in an impartible estate by custom is to be assessed in the status of a HUF. However, section 27(ii) will continue to be applicable in relation to impartible estates by grant or covenant,.

(iv) **Member of a co-operative society etc. [Section 27(iii)]** – A member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a House Building Scheme of a society/company/association, shall be deemed to be owner of that building or part thereof allotted to him although the co-operative society/company/ association is the legal owner of that building.

(v) **Person in possession of a property [Section 27(iia)]** – A person who is allowed to take or retain the possession of any building or part thereof in part performance of a contract

of the nature referred to in section 53A of the Transfer of Property Act shall be the deemed owner of that house property. This would include cases where the –

- (1) possession of property has been handed over to the buyer
- (2) sale consideration has been paid or promised to be paid to the seller by the buyer
- (3) sale deed has not been executed in favour of the buyer, although certain other documents like power of attorney/agreement to sell/will etc. have been executed.

In all the above cases, the buyer would be deemed to be the owner of the property although it is not registered in his name.

(vi) Person having right in a property for a period not less than 12 years [Section 27(iiib)] – A person who acquires any rights in or with respect to any building or part thereof, by virtue of any transaction as is referred to in section 269UA(f) i.e. transfer by way of lease for not less than 12 years, shall be deemed to be the owner of that building or part thereof.

Exception – Any rights by way of lease from month to month or for a period not exceeding one year.

2.13 Cases where income from house property is exempt from tax

Sl. No.	Section	Particulars
1	10(1)	Income from any farm house forming part of agricultural income.
2	10(19A)	Annual value of any one palace in the occupation of an ex-ruler.
3	10(20)	Income from house property of a local authority.
4	10(21)	Income from house property of an approved scientific research association.
5	10(23C)	Property income of universities, educational institutions, etc.
6	10(24)	Property income of any registered trade union.
7	11	Income from house property held for charitable or religious purpose.
8	13A	Property income of any political party.
9	22	Property used for own business or profession
10	23(2)	One self-occupied property of an individual/HUF

UNIT – 3 : PROFITS AND GAINS OF BUSINESS OR PROFESSION

Learning Objectives

After studying this unit, you would be able to understand -

- ◆ the meaning of “business” and “profession”
- ◆ when income is chargeable under this head
- ◆ what is a speculative transaction
- ◆ what is the tax treatment of loss incurred in speculative business
- ◆ what are the admissible deductions while computing income under this head
- ◆ what are the inadmissible deductions while computing income under this head
- ◆ when certain receipts are deemed to be income chargeable to tax under this head
- ◆ which are the deductions allowable only on actual payment
- ◆ who are the assesseees required to compulsorily maintain books of account
- ◆ when audit of accounts is compulsory
- ◆ who are the assesseees to whom presumptive tax provisions apply
- ◆ how income is computed on presumptive basis in case of such assesseees
- ◆ how business income is computed in cases where income is partly agricultural and partly business in nature

3.1 Meaning of ‘Business’, ‘Profession’ and ‘Profits’

(i) The tax payable by an assessee on his income under this head is in respect of the profits and gains of any business or profession, carried on by him or on his behalf during the previous year. The term “business” has been defined in section 2(13) to “include any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture”. But the term “profession” has not been defined in the Act. It means an occupation requiring some degree of learning. Thus, a painter, a sculptor, an author, an auditor, a lawyer, a doctor, an architect and, even an astrologer are persons who can be said to be carrying on a profession but not business. The term ‘profession’ includes vocation as well [Section 2(36)]. However, it is not material whether a person is carrying on a ‘business’ or ‘profession’ or ‘vocation’ since for purposes of assessment, profits from all these sources are treated and taxed alike.

(ii) Business necessarily means a continuous exercise of an activity; nevertheless, profit from a single venture in the nature of trade would also be assessable under this head if the venture had come to an end or after the entire cost had been recouped. For example, where a person had purchased a piece of land, got it surveyed, laid down a scheme of development,

divided it into a number of building plots and sold some of the plots from time to time, though he would not be charged tax on a notional profit made on the individual sale of plots, he would be liable to pay tax on the surplus after all the plots have been sold and the venture has come to an end or after he has recovered the cost of all the plots and expenditure incidental thereto and has a surplus left.

(iii) Profits may be realised in money or in money's worth, i.e., in cash or in kind. Where profit is realised in any form other than cash, the cash equivalent of the receipt on the date of receipt must be taken as the value of the income received in kind. Capital receipts are not generally to be taken into account while computing profits under this head. Payment voluntarily made by persons who were under no obligation to pay anything at all would be income in the hands of the recipient, if they were received in the course of a business or by the exercise of a profession or vocation. Thus, any amount paid to a lawyer by a person who was not a client, but who has been benefited by the lawyer's professional service to another would be assessable as the lawyer's income.

(iv) Application of the gains of trade is immaterial. Gains made even for the benefit of the community by a public body would be liable to tax. To attract the provisions of section 28, it is necessary that the business, profession or vocation should be carried on at least for some time during the accounting year but not necessarily throughout that year and not necessarily by the assessee-owner personally, but it should be under his direction and control.

(v) The charge is not on the gross receipts but on the profits and gains in their natural and proper sense. Profits are ascertained on ordinary principles of commercial trading and commercial accounting. According to section 145, income has to be computed in accordance with the method of accounting regularly and consistently employed by the assessee. The assessee may account for his receipts on the cash basis or mercantile basis.

(vi) The Act, however, contains certain provisions for determining how the income is to be assessed. These must be followed in every case of business or profession. The illegality of a business, profession or vocation does not exempt its profits from tax: the revenue is not concerned with the taint of illegality in the income or its source. Income is taxable even if the assessee is carrying on the business, profession or vocation without any profit motive. The liability to tax arises once income arises to the assessee; the motive or purpose of earning the income is immaterial. Thus, profit motive is not essential for describing the income from that activity as income from business or profession.

(vii) The profits of each distinct business must be computed separately but the tax chargeable under this section is not on the separate income of every distinct business but on the aggregate profits of all the business carried on by the assessee. Profits should be computed after deducting the losses and expenses incurred for earning the income in the regular course of the business, profession, or vocation unless the loss or expenses is expressly or by necessary implication, disallowed by the Act.

(viii) Income arising from business assets which are temporarily let out e.g., an oil mill, cinema theatre, hotel, ginning or textile factory, rice mill or jute press would be assessable as

business income. But if the commercial asset is permanently let the income is taxable as income from house property or income from other sources, depending on the facts and circumstances of the case.

3.2 Income Chargeable under this Head [Section 28]

The various items of income chargeable to tax as income under the head 'profits and gains of business or profession' are as under:

- (i) Income arising to any person by way of profits and gains from the business, profession or vocation carried on by him at any time during the previous year.
- (ii) Any compensation or other payment due to or received by:
 - (a) Any person, by whatever name called, managing the whole or substantially the whole of (i) the affairs of an Indian company or (ii) the affairs in India of any other company at or in connection with the termination of his management or office or the modification of any of the terms and conditions relating thereto;
 - (b) any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person at or in connection with the termination of the agency or the modification of any of the terms and conditions relating thereto ;
 - (c) any person, for or in connection with the vesting in the Government or any corporation owned or controlled by the Government under any law for the time being in force, of the management of any property or business ;

By taxing compensation received on termination of agency or on the takeover of management (which is a capital receipt) as income from business, section 28(ii) provides exception to the general rule that capital receipts are not income taxable in the hands of the recipient.

(iii) Income derived by any trade, professional or similar associations from specific services rendered by them to their members. It may be noted that this forms an exception to the general principle governing the assessment of income of mutual associations such as chambers of commerce, stock brokers' associations etc. As a result a trade, professional or similar association performing specific services for its members is to be deemed as carrying on business in respect of these services and on that assumption the income arising therefrom is to be subjected to tax. For this purpose, it is not necessary that the income received by the association should be definitely or directly related to these services.

(iv) Profits on sale of a licence granted under the Imports (Control) Order, 1955 made under the Imports and Exports (Control) Act, 1947.

(v) Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India.

(vi) Any Customs duty or Excise duty drawback repaid or repayable to any person against export under the Customs and Central Excise Duties Drawback Rules, 1971.

(vii) Any profit on the transfer of the Duty Entitlement Pass Book Scheme, being Duty

Remission Scheme, under the export and import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992.

(viii) Any profit on the transfer of Duty Free Replenishment Certificate, being Duty Remission Scheme, under the export and import policy formulated and announced under section 5 of the Foreign Trade (Development and Regulation) Act, 1992.

(ix) The value of any benefit or perquisite whether convertible into money or not, arising from business or the exercise of any profession.

(x) Any interest, salary, bonus, commission or remuneration, by whatever name called, due to or received by a partner of a firm from such firm will be deemed to be income from business. However, where any interest, salary, bonus, commission or remuneration by whatever name called, or any part thereof has not been allowed to be deducted under section 40(b), in the computation of the income of the firm the income to be taxed shall be adjusted to the extent of the amount disallowed. In other words, suppose a firm pays interest to a partner at 20% simple interest p.a. The allowable rate of interest is 12% p.a. Hence the excess 8% paid will be disallowed in the hands of the firm. Since the excess interest has suffered tax in the hands of the firm, the same will not be taxed in the hands of the partner.

(xi) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy will be taxable as income from business. "Keyman insurance policy" means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected in any manner whatsoever with the business of the first mentioned person.

(xii) Any sum received or receivable, in cash or kind, on account of any capital asset (in respect of which deduction has been allowed under section 35AD) being demolished, destroyed, discarded or transferred.

(xiii) any sum whether received or receivable, in cash or kind, under an agreement

(a) for not carrying out any activity in relation to any business; or

(b) not to share any know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services.

However, the above sub-clause (a) shall not apply to -

(i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business, which is chargeable under the head "Capital gains";

(ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

The *Explanation* for the purposes of this clause provides that

- (i) "agreement" includes any arrangement or understanding or action in concert,-
 - (A) whether or not such arrangement, understanding or action is formal or in writing; or
 - (B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;
- (ii) "service" means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging.

3.3 Speculation Business

Explanation 2 to section 28 specifically provides that where an assessee carries on speculative business, that business of the assessee must be deemed as distinct and separate from any other business. This becomes necessary because section 73 provides that losses in speculation business unlike other business, cannot be set-off against the profits of any business other than a speculation business. Likewise, a loss in speculation business carried forward to a subsequent year can be set-off only against the profit and gains of any speculative business in the subsequent year. Profits and losses resulting from speculative transaction must, therefore, be treated as separate and distinct from other profits and gains of business and profession.

According to section 43(5), the expression "speculative transaction" means a transaction in which a contract for the purchase or sales of any commodity including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips. Further, in view of *Explanation* to section 73, the transaction of purchase and sale of shares by a company, other than an investment company and a company whose principal business is the business of **trading in shares** or banking or the granting of loans and advances, is also be deemed to be a speculative transaction. However, the following forms of transactions shall not be deemed to be speculative transaction:

- (i) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for the actual delivery of goods manufactured by him or merchandise sold by him ; or
- (ii) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuation; or
- (iii) a contract entered into by a member of a forward market or stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as a member; or

(iv) an eligible transaction carried out in respect of trading in derivatives in a recognized stock exchange.

(a) "eligible transaction" means any transaction,–

(A) carried out electronically on screen-based systems through a stock broker or sub-broker or such other intermediary registered under section 12 of the Securities and Exchange Board of India Act, 1992 in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 and the rules, regulations or bye-laws made or directions issued under those Acts or by banks or mutual funds on a recognised stock exchange; and

(B) which is supported by a time stamped contract note issued by such stock broker or sub-broker or such other intermediary to every client indicating in the contract note, the unique client identity number allotted under any Act referred to in sub-clause (A) and permanent account number allotted under this Act;

(b) "recognised stock exchange" means a recognised stock exchange as referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 and which fulfils such conditions as may be prescribed and notified by the Central Government for this purpose. The stock exchanges notified as recognized stock exchanges for the purpose of section 43(5) are National Stock Exchange, Bombay Stock Exchange, MCX Stock Exchange and United Stock Exchange.

(v) an eligible transaction in respect of trading in commodity derivatives carried out in a recognized association, ***which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013.***

(a) "eligible transaction" means any transaction,–

(A) carried out electronically on screen-based systems through a member or an intermediary registered under the bye-laws, rules and regulations of the recognized association for trading in commodity derivative in accordance with the provisions of the Forward Contracts (Regulation) Act, 1952 and the rules, regulations or bye-laws made or directions issued under that Act on a recognized association; and

(B) which is supported by a time stamped contract note issued by such member or an intermediary to every client indicating in the contract note, the unique client identity number allotted under the Act, rules, regulations or bye-laws referred to in sub-clause (A), unique trade number and permanent account number allotted under this Act;

(b) "recognised association" means a recognised association as referred to in clause (j) of section 2 of the Forward Contracts (Regulation) Act, 1952 and which fulfils such conditions as may be prescribed and is notified by the Central Government for this purpose.

Thus, in all the cases where actual delivery or transfer of the commodity or scrips takes place, the transaction would not amount to speculative transaction, however highly speculative it may

be in its nature. The actual delivery may be symbolic and includes delivery effected by the mere transfer of delivery orders according to trade practice.

The instances stated above constitute the exceptions specifically provided by the Act, whereby certain transactions (e.g., hedging contracts) entered into by manufacturers and merchants in the course of their business to guard against the loss through price fluctuations are excluded from the definition of speculative transactions. This provision should be liberally construed to cover not only hedging forward contracts for purchase of goods but also such contracts for sale.

The Supreme Court held in *CIT v. Shantilal (P) Ltd.* [1983] 144 ITR 57 (SC) that an award of damages for breach of contract is not the same thing as a party to the contract accepting satisfaction of the contract otherwise than in accordance with the original terms thereof. In this view of the matter, the court held that in a case where a company contracted to sell a certain commodity to a party but was unable to effect delivery due to a sharp rise in the price of the commodity and the dispute which arose out of such breach of contract was settled by payment of damages as decided by an arbitrator, the transaction could not be described as a 'speculative transaction' within the meaning of section 43(5). This principle has been followed by various High Courts also.

3.4 Computation of income from business [Section 29]

(i) According to section 29, the profits and gains of any business or profession are to be computed in accordance with the provisions contained in sections 30 to 43D. It must, however, be remembered that in addition to the specific allowances and deductions stated in sections 30 to 36, the Act further permits allowance of items of expenses under the residuary section 37(1), which extends the allowance to items of business expenditure not covered by sections 30 to 36, where these are allowable according to accepted commercial practices.

(ii) An item of loss or expenditure not falling within any of the express deductions may be allowed if it is deductible on the basis of common principles of commercial expediency. Thus, in determining whether a particular item (other than those covered by sections 30 to 36) is deductible from profits, it is necessary first to enquire whether the deduction is expressly or by necessary implication prohibited by the Act and then, if it is not so prohibited, to consider whether it is of such nature that it should be charged against income in the computation of the "profits and gains of business or profession". Accordingly, a loss due to embezzlement or theft of cash by an employee during the course of business is allowable as a deduction in computing the business profit, even though they are not covered by any specific provision of the Act. Losses of non-capital nature which are incidental to the trade and arise unexpectedly in the regular course of the business would be allowed as losses incidental to the trade though there is no specified provision in the Act for allowing such deductions. Examples of such losses are embezzlement, theft, robbery or destruction of assets, overdrawing by employees, loss of stock in trade by damage or by fire or by ravages of white ants or by enemy action during war or by negligence or fraud of employees, etc.

(iii) Where a trader stands surety for the debt of another and such guarantee is not in the course of or for the purposes of trade, any payment made as a result of such guarantee

cannot be deducted as a business loss except in a case where the contract of guarantee is entered into in the course of business pursuant to a trade or custom of which mutual accommodation is the essence e.g., trader standing surety for one another. Loss of cash in a bank on account of robbery by dacoits or loss through burglary of cash which the assessee is under legal obligation or business necessity required to keep in till it would be allowable as loss incidental to the trade. Losses arising from payments made as advances to employees and money lent by the managed company to the managing agents which had become irrecoverable would be incidental to the business provided that the amounts paid in advance or as loan were so made with reasonable business prudence and hence would be deductible.

(iv) Loss caused by embezzlement is allowable as a deduction not necessarily in the year in which the embezzlement takes place, but when there is no reasonable chance of obtaining restitution and the amount is found to be irrecoverable. Normally when a businessman writes off the amount, it is a prima facie evidence of the fact that the amount has become irrecoverable. If embezzled or stolen moneys which are allowed as deduction in any year are subsequently recovered, they should be brought to tax as a revenue receipt from the business in the year of recovery.

(v) In respect of wasting assets or exhaustion of capital, no deduction is allowable from the income derived from such capital or wasting asset. Accordingly, where an annuity is purchased, the entire amount of annuity received is taxable regardless of the capital paid away and exhausted for the purchase of annuity. Likewise, in the case of a lease, the capital cost of the lease is not allowed to be deducted over the life of the lease.

3.5 Admissible Deductions

(i) **Rent, rates, repairs and insurance for buildings [Section 30]:** Section 30 allows deduction in respect of the rent, rates, taxes, repairs and insurance of buildings used by the assessee for the purpose of his business or profession. However, where the premises are used partly for business and partly for other purposes, only a proportionate part of the expenses attributable to that part of the premises used for purposes of business will be allowed as a deduction. Where the assessee has sublet a part of the premises, the allowance under the section would be confined to the difference between the rent paid by the assessee and the rent recovered from the sub-tenant. The rent payable would be an allowable deduction under this section even though the income from the property in respect of which it is paid may be exempt from taxation in the hands of the owner. Where the assessee himself is owner of the premises and occupies them for his business purposes, no notional rent would be allowed under this section. However, where a firm runs its business in the premises owned by one of its partners, the rent payable to the partner will be an allowable deduction to the extent it is reasonable and is not excessive.

Apart from rent, this section allows deductions in respect of expenses incurred on account of repairs to building in case where (i) the assessee is the owner of the building or (ii) the assessee is a tenant who has undertaken to bear the cost of repairs to the premises. Even if the assessee occupies the premises otherwise than as a tenant or owner, i.e., as a lessee,

licensee or mortgagee with possession, he is entitled to a deduction under the section in respect of current repairs to the premises.

In addition, deductions are allowed in respect of expenses by way of land revenue, local rates, municipal taxes and insurance in respect of the premises used for the purposes of the business or profession. Cesses, rates and taxes levied by a foreign Government are also allowed. Where the premises in respect of which these expenses are incurred are not utilized wholly for the purposes of the business, then, the deduction allowable should be of an amount proportionate to the use of the premises for the purposes of the business.

(ii) Repairs and insurance of machinery, plant and furniture [Section 31] : Section 31 allows deduction in respect of the expenses on current repairs and insurance of machinery, plant and furniture in computing the income from business or profession. In order to claim this deduction the assets must have been used for purposes of the assessee's own business the profits of which are being taxed. The word 'used' has to be read in a wide sense so as to include a passive as well as an active user. Thus, insurance and repair charges of assets which have been discarded (though owned by the assessee) or have not been used for the business during the previous year would not be allowed as a deduction. Even if an asset is used for a part of the previous year, the assessee is entitled to the deduction of the full amount of expenses on repair and insurance charges and not merely an amount proportionate to the period of use.

The term 'repairs' will include renewal or renovation of an asset but not its replacement or reconstruction. Also, the deduction allowable under this section is only of current repairs but not arrears of repairs for earlier years even though they may still rank for a deduction under section 37(1).

The deduction allowable in respect of premia paid for insuring the machinery, plant or furniture is subject to the following conditions: (i) The insurance must be against the risk of damage or destruction of the machinery, plant or furniture. (ii) The assets must be used by the assessee for the purposes of his business or profession during the accounting year. (iii) The premium should have been actually paid (or payable under the mercantile system of accounting). The premium may even take the form of contribution to a trade association which undertakes to indemnify and insure its members against loss; such premium or contribution would be deductible as an allowance under this section even if a part of it is returnable to the insured in certain circumstances. It does not matter if the payment of the claim will enure to the benefit of someone other than the owner.

Cost of repairs and current repairs of capital nature not to be allowed : As per section 30(a), deduction for cost of repairs to the premises occupied by the assessee as a tenant and the amount paid on account of current repairs to the premises occupied by the assessee, otherwise than as a tenant, is allowed.

As per section 31, the amount paid on account of current repairs of machinery, plant or furniture is allowed as deduction in the computation of income under the head "profits and gains of business or profession"

Under the Income-tax Act, 1961, the concept of capital and revenue is of fundamental importance. The Income-tax Act, 1961 is an Act to bring to charge only revenue and not

capital. Wherever the legislature has felt that capital receipts have to be charged to income-tax they have specifically included such capital receipts in the definition of income e.g. Capital gains. In the same way, wherever the legislature desired that capital expenditure should be allowed as a deduction, specific provisions have been made for such allowance e.g. capital expenditure on scientific research. While computing income under the Income-tax Act, 1961, only revenue receipts are to be considered against which only revenue expenditure is allowable unless the Act specifically allows the deduction of capital expenditure. Hence it is clear that in respect of cost of repairs and current repairs, as per correct accounting principles, only expenditure of revenue nature can be allowed.

To clarify this, the *Explanation* to section 30 and section 31 provides that the amount paid on account of the cost of repairs and the amount paid on account of current repairs shall not include any expenditure in the nature of capital expenditure.

(iii) Depreciation [Section 32]

(1) Section 32 allows a deduction in respect of depreciation resulting from the diminution or exhaustion in the value of certain capital assets.

The *Explanation* to this section provides that deduction on account of depreciation shall be made compulsorily, whether or not the assessee has claimed the deduction in computing his total income.

(2) The allowance of depreciation which is regulated by Rule 5 of the Income-tax Rules, 1962, is subject to the following conditions which are cumulative in their application.

(a) The assets in respect of which depreciation is claimed must belong to either of the following categories, namely:

- (i) buildings, machinery, plant or furniture, being tangible assets;
- (ii) know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1st April, 1998.

The depreciation in the value of any other capital assets cannot be claimed as a deduction from the business income. No depreciation is allowable on the cost of the land on which the building is erected because the term 'building' refers only to superstructure but not the land on which it has been erected. The term 'plant' as defined in section 43(3) includes books, vehicles, scientific apparatus and surgical equipments. The expression 'plant' includes part of a plant (e.g., the engine of a vehicle); machinery includes part of a machinery and building includes a part of the building. However, the word 'plant' does not include an animal, human body or stock-in-trade. Thus plant includes all goods and chattels, fixed or movable, which a businessman keeps for employment in his business with some degree of durability. Similarly the term 'buildings' includes within its scope roads, bridges, culverts, wells and tubewells.

(b) The assets should be actually used by the assessee for purposes of his business during the previous year - The asset must be put to use at any time during the previous year. The amount of depreciation allowance is not proportionate to the period of use during the previous year.

Asset used for less than 180 days - However, it has been provided that where any asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, depreciation shall be allowed at 50 per cent of the allowable depreciation according to the percentage prescribed in respect of the block of assets comprising such asset. It is significant to note that this restriction applies only to the year of acquisition and not for subsequent years.

If the assets are not used exclusively for the business of the assessee but for other purposes as well, the depreciation allowable would be a proportionate part of the depreciation allowance to which the assessee would be otherwise entitled. This is provided in section 38.

Depreciation would be allowable to the owner even in respect of assets which are actually worked or utilized by another person e.g., a lessee or licensee. The deduction on account of depreciation would be allowed under this section to the owner who has let on hire his building, machinery, plant or furniture provided that letting out of such assets is the business of the assessee. In other cases where the letting out of such assets does not constitute the business of the assessee, the deduction on account of depreciation would still be allowable under section 57(ii).

Use includes passive use in certain circumstances: One of the conditions for claim of depreciation is that the asset must be "used for the purpose of business or profession". Courts have held that, in certain circumstances, an asset can be said to be in use even when it is "kept ready for use". For example, depreciation can be claimed by a transport company on spare engines kept in store in case of need, though they have not actually been used by the company. Hence, in such cases, the term "use" embraces both active use and passive use. However, such passive use should also be for business purposes.

The Delhi High Court, in *CIT v. Insilco Ltd.* (2009) 179 Taxman 55, observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though ready for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

(c) The assessee must own the assets, wholly or partly - In the case of buildings, the assessee must own the superstructure and not necessarily the land on which the building is constructed. In such cases, the assessee should be a lessee of the land on which the building stands and the lease deed must provide that the building will belong to the lessor of the land upon the expiry of the period of lease. Thus, no depreciation will be allowed to an assessee in respect of an asset which he does not own but only uses or hires for purposes of his business.

However, in this connection, students may note that the *Explanation 1* to section 32 provides

that where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy, and any capital expenditure is incurred by the assessee for the purposes of the business or profession or the construction of any structure or doing of any work by way of renovation, extension or improvement to the building, then depreciation will be allowed as if the said structure or work is a building owned by the assessee.

Depreciation is allowable not only in respect of assets "wholly" owned by the assessee but also in respect of assets "partly" owned by him and used for the purposes of his business or profession.

(3) In case of succession of firm/sole proprietary concern by a company or amalgamation or demerger of companies - In order to restrict the double allowance under the proviso to section 32, in the cases of succession or amalgamation or demerger, the aggregate deduction in respect of depreciation allowable in the hands of the predecessor and the successor or in the case of amalgamating company and the amalgamated company or in the case of the demerged company and the resulting company, as the case may be, shall not exceed the amount of depreciation calculated at the prescribed rates as if the succession/amalgamation, demerger had not taken place. It is also provided that such deduction shall be apportioned between the two entities in the ratio of the number of days for which the assets were used by them.

In case of conversion of a private company or an unlisted public company into an LLP, fulfilling the conditions mentioned in section 47(xiiib), the aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them.

(4) Hire purchase - In the case of assets under the hire purchase system the allowance for depreciation would under *Circular No. 9 of 1943 R. Dis. No. 27(4) I.T. 43 dated 23-3-1943*, be granted as follows :

1. In every case of payment purporting to be for hire purchase, production of the agreement under which the payment is made would be insisted upon by the department.
2. Where the effect of an agreement is that the ownership of the asset is at once transferred on the lessee the transaction should be regarded as one of purchase by instalments and consequently no deduction in respect of the hire amount should be made. This principle will be applicable in a case where the lessor obtains a right to sue for arrears of installments but has no right to recover the asset back from the lessee. Depreciation in such cases should be allowed to the lessee on the hire purchase price determined in accordance with the terms of hire purchase agreement.
3. Where the terms of an agreement provide that the asset shall eventually become the property of the hirer or confer on the hirer an option to purchase an asset, the transaction should be regarded as one of hire purchase. In such case, periodical payments made by

the hirer should for all tax purposes be regarded as made up of (i) the consideration for hirer which will be allowed as a deduction in assessment, and (ii) payment on account of the purchase price, to be treated as capital outlay and depreciation being allowed to the lessee on the initial value namely, the amount for which the hired assets would have been sold for cash at the date of the agreement. The allowance to be made in respect of the hire should be the amount of the difference between the aggregate amount of the periodical payments under the agreement and the initial value as stated above. The amount of this allowance should be spread over the duration of the agreement evenly. If, however, agreement is terminated either by outright purchase of the asset or by its return to the seller, the deduction should cease as from the date of termination of agreement.

For the purpose of allowing depreciation an assessee claiming deduction in respect of the assets acquired on hire purchase would be required to furnish a certificate from the seller or any other suitable documentary evidence in respect of the initial value or the cash price of the asset. In cases where no such certificate or other evidence is furnished the initial value of the assets should be arrived at by computing the present value of the amount payable under the agreement at an appropriate per centum. For the purpose of allowing depreciation the question whether in a particular case the assessee is the owner of the hired asset or not is to be decided on a consideration of all the facts and circumstances of each case and the terms of the hire purchase agreement. Where the hired asset is originally purchased by the assessee and is registered in his name, the mere fact that the payment of the price is spread over the specified period and is made in installments to suit the needs of the purchaser does not disentitle the assessee from claiming depreciation in respect of the asset, since the assessee would be the real owner although the payment of purchase price is made subsequent to the date of acquisition of the asset itself.

(5) Computation of Depreciation Allowance - Depreciation allowance will be calculated on the following basis:

- (i) In the case of assets of an undertaking engaged in generation or generation and distribution of power, such percentage on the actual cost to the assessee as prescribed by Rule 5(1A).

Rule 5(1A) - As per this rule, the depreciation on the abovementioned assets shall be calculated at the percentage of the actual cost at rates specified in Appendix IA of these rules. However, the aggregate depreciation allowed in respect of any asset for different assessment years shall not exceed the actual cost of the asset. It is further provided that such an undertaking as mentioned above has the option of being allowed depreciation on the written down value of such block of assets as are used for its business at rates specified in Appendix I to these rules.

However, such option must be exercised before the due date for furnishing return under section 139(1) for the assessment year relevant to the previous year in which it begins to generate power. It is further provided that any such option once exercised shall be final and shall apply to all subsequent assessment years.

- (ii) In the case of any block of assets, at such percentage of the written down value of the block, as may be prescribed by Rule 5(1).

Block of Assets - 1. A "block of assets" is defined in clause (11) of section 2, as a group of assets falling within a class of assets comprising—

- (a) tangible assets, being buildings, machinery, plant or furniture;
- (b) intangible assets, being know-how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature,

in respect of which the same percentage of depreciation is prescribed.

Know-how - In this context, 'know-how' means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil-well or other sources of mineral deposits (including searching for discovery or testing of deposits for the winning of access thereto).

- (iii) **Additional depreciation on Plant & Machinery acquired by an Industrial Undertaking:** Additional depreciation is allowed on any new machinery or plant (other than ships and aircraft) acquired and installed after 31.3.2005 by an assessee engaged in the business of manufacture or production of any article or thing or in the business of generation or generation and distribution of power at the rate of 20% of the actual cost of such machinery or plant.

Such additional depreciation will not be available in respect of:

- (i) any machinery or plant which, before its installation by the assessee, was used within or outside India by any other person; or
 - (ii) any machinery or plant installed in office premises, residential accommodation, or in any guest house; or
 - (iii) office appliances or road transport vehicles; or
 - (iv) any machinery or plant, the whole or part of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and Gains of Business or Profession" of any one previous year.
- (iv) **Terminal depreciation:** In case of a power concern as covered under clause (i) above, if any asset is sold, discarded, demolished or otherwise destroyed in the previous year, the depreciation amount will be the amount by which the monies payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, falls short of the written down value thereof. The depreciation will be available only if the deficiency is actually written off in the books of the assessee.

"Moneys payable" in respect of any building, machinery, plant or furniture includes—

- (a) any insurance, salvage or compensation moneys payable in respect thereof;
- (b) where the building, machinery, plant or furniture is sold, the price for which it is sold, so,

however, that where the actual cost of a motor-car is, in accordance with the proviso to clause (1) of section 43, taken to be ₹ 25,000, the moneys payable in respect of such motor-car shall be taken to be a sum which bears to the amount for which the motor-car is sold or, as the case may be, the amount of any insurance, salvage or compensation moneys payable in respect thereof (including the amount of scrap value, if any) the same proportion as the amount of ₹ 25,000 bears to the actual cost of the motor-car to the assessee as it would have been computed before applying the said proviso;

“Sold” includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company or a transfer of any asset by a banking company to a banking institution in a scheme of amalgamation of such banking company with the banking institution, sanctioned and brought into force by the Central Government.

(6) Actual Cost [Section 43(1)] :The expression “actual cost” means the actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

Actual cost in certain special situations [Explanations to section 43(1)]

(i) Where an asset is used for the purposes of business after it ceases to be used for scientific research related to that business, the actual cost to the assessee for depreciation purposes shall be the actual cost to the assessee as reduced by any deduction allowed under section 35(1)(iv) [*Explanation 1*].

(ii) Where an asset is acquired by way of gift or inheritance, its actual cost shall be the written down value to the previous owner [*Explanation 2*].

(iii) Where, before the date of its acquisition by the assessee, the asset was at any time used by any other person for the purposes of his business or profession, and the Assessing Officer is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was the reduction of liability of income-tax directly or indirectly to the assessee (by claiming depreciation with reference to an enhanced cost) the actual cost to the assessee shall be taken to be such an amount which the Assessing Officer may, with the previous approval of the Joint Commissioner, determine, having regard to all the circumstances of the case [*Explanation 3*].

(iv) Where any asset which had once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter ceased to be his property by reason of transfer or otherwise, is re-acquired by him, the actual cost to the assessee shall be —

- (a) the written down value at the time of original transfer; or
- (b) the actual price for which the asset is re-acquired by him

whichever is less [*Explanation 4*].

(v) Where before the date of acquisition by the assessee say, Mr. A, the assets were at any

time used by any other person, say Mr. B, for the purposes of his business or profession and depreciation allowance has been claimed in respect of such assets in the case of Mr. B and such person acquires on lease, hire or otherwise, assets from Mr. A, then, the actual cost of the transferred assets, in the case of Mr. A, shall be the same as the written down value of the said assets at the time of transfer thereof by Mr. B [*Explanation 4A*].

We can explain the above as follows—

A person (say "A") owns an asset and uses it for the purposes of his business or profession. A has claimed depreciation in respect of such asset. The said asset is transferred by A to another person (say "B"). A then acquires the same asset back from B on lease, hire or otherwise. B being the new owner will be entitled to depreciation. In the above situation, the cost of acquisition of the transferred assets in the hands of B shall be the same as the written down value of the said assets at the time of transfer.

Explanation 4A overrides Explanation 3 - Explanation 3 to section 43(1) deals with a situation where a transfer of any asset is made with the main purpose of reduction of tax liability (by claiming depreciation on enhanced cost), and the Assessing Officer, having satisfied himself about such purpose of transfer, may determine the actual cost having regard to all the circumstances of the case.

In the Explanation 4A, a *non-obstante* clause has been included to the effect that Explanation 4A will have an overriding effect over Explanation 3. The result of this is that there is no necessity of finding out whether the main purpose of the transaction is reduction of tax liability. Explanation 4A is activated in every situation described above without inquiring about the main purpose.

(vi) Where a building which was previously the property of the assessee is brought into use for the purposes of the business or profession, its actual cost to the assessee shall be the actual cost of the building to the assessee, as reduced by an amount equal to the depreciation calculated at the rates in force on that date that would have been allowable had the building been used for the purposes of the business or profession since the date of its acquisition by the assessee [*Explanation 5*].

(vii) When any capital asset is transferred by a holding company to its subsidiary company or by a subsidiary company to its holding company then, if the conditions specified in section 47(iv) or (v) are satisfied, the transaction not being regarded as a transfer of a capital asset, the actual cost of the transferred capital asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the capital asset for the purposes of its own business [*Explanation 6*].

(viii) In a scheme of amalgamation, if any capital asset is transferred by the amalgamating company to the amalgamated company, the actual cost of the transferred capital assets to the amalgamated company will be taken at the same amount as it would have been taken in the case of the amalgamating company had it continued to hold it for the purposes of its own business [*Explanation 7*].

In the case of a demerger, where any capital asset is transferred by the demerged company to the resulting company, the actual cost of the transferred asset to the resulting company shall

be taken to be the same as it would have been if the demerged company had continued to hold the asset. However, the actual cost shall not exceed the WDV of the asset in the hands of the demerged company [*Explanation 7A*].

(ix) Certain taxpayers have, with a view to obtain more tax benefits and reduce the tax outflow, resorted to the method of capitalising interest paid or payable in connection with acquisition of an asset relatable to the period after such asset is first put to use. Certain judicial rulings also favoured this approach. This capitalisation implies inclusion of such interest in the 'Actual Cost' of the asset for the purposes of claiming depreciation, investment allowance etc. under the Income-tax Act, 1961. This was never the legislative intent nor was it in accordance with recognised accounting practices. Therefore, with a view to counter-acting tax avoidance through this method and placing the matter beyond doubt, *Explanation 8* to section 43(1) provides that any amount paid or payable as interest in connection with the acquisition of an asset and relatable to period after asset is first put to use shall not be included and shall be deemed to have never been included in the actual cost of the asset [*Explanation 8*].

(x) Where an asset is or has been acquired by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944 [*Explanation 9*].

(xi) Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee.

However, where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee [*Explanation 10*].

(xii) Where an asset is acquired outside India by an assessee, being a non-resident and such asset is brought by him to India and used for the purposes of his business or profession, the actual cost of asset to the assessee shall be the actual cost the asset to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee [*Explanation 11*].

(xiii) Where any capital asset is acquired under a scheme for corporatisation of a recognised stock exchange in India approved by the SEBI, the actual cost shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatization [*Explanation 12*].

(xiv) *Explanation 13* has been inserted in section 43(1) to provide that the actual cost of any capital asset, on which deduction has been allowed or is allowable to the assessee under

section 35AD, shall be nil. This would be applicable in the case of transfer of asset by the assessee where -

- (1) the assessee himself has claimed deduction under section 35AD; or
- (2) the previous owner has claimed deduction under section 35AD. This would be applicable where the capital asset is acquired by the assessee by way of -
 - (a) gift, will or an irrevocable trust;
 - (b) any distribution on liquidation of the company;
 - (c) any distribution of capital assets on total or partial partition of a HUF;
 - (d) any transfer of a capital asset by a holding company to its 100% subsidiary company, being an Indian company;
 - (e) any transfer of a capital asset by a subsidiary company to its 100% holding company, being an Indian company;
 - (f) any transfer of a capital asset by the amalgamating company to an amalgamated company in a scheme of amalgamation, if the amalgamated company is an Indian company;
 - (g) any transfer of a capital asset by the demerged company to the resulting company in a scheme of demerger, if the resulting company is an Indian company;
 - (h) any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of demutualization or corporatisation of a recognized stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company (fulfilling the conditions specified);
 - (i) any transfer of a capital asset or intangible asset by a sole proprietary concern to a company, where the sole proprietary concern is succeeded by a company (fulfilling the conditions specified) which would have been regarded as actual cost had there been no such corporatisation.
 - (j) any transfer of a capital asset by a company to an LLP as a result of conversion of the company into LLP (fulfilling the conditions prescribed).

Definition of plant [Section 43(3)] – “Plant” includes ships, vehicles, books, scientific apparatus and surgical equipment used for the purposes of business or profession but does not include tea bushes or livestock or buildings or furniture and fittings.

(7) Written down value [Section 43(6)] - (i) In the case of assets acquired by the assessee during the previous year, the written down value means the actual cost to the assessee.

(ii) In the case of assets acquired before the previous year, the written down value would be the actual cost to the assessee less the aggregate of all deductions actually allowed in respect

of depreciation. For this purpose, any depreciation carried forward is deemed to be depreciation actually allowed [Section 43(6)(c)(i) read with *Explanation 3*].

The written down value of any asset shall be worked out as under in accordance with section 43(6)(c):

- (1) The aggregate of the written down value of the block of assets at the beginning of the previous year.
 - (2) The sum arrived at as above shall be increased by the actual cost of any asset falling within that block which is acquired by the assessee during the previous year.
 - (3) The sum so arrived at shall be reduced by the sale proceeds and other amounts receivable by the assessee with regard to any asset falling within that block which is sold, discarded, demolished or destroyed during that previous year.
- (iii) When in the case of a succession to business or profession, an assessment is made on the successor under section 170(2), the written down value of an asset or block of assets shall be the amount which would have been taken as the written down value if the assessment had been made directly on the person succeeded to [*Explanation 1* to section 43(6)].
- (iv) Where in any previous year any block of assets is transferred by a holding company to a subsidiary company or vice versa and the conditions of clause 47(iv) or (v) are satisfied or by an amalgamating company to an amalgamated company the latter being an Indian company then the actual cost of the block of assets in the case of transferee-company or amalgamated company as the case may be, shall be the written down value of the block of assets as in the case of the transferor company or amalgamating company, as the case may be, for the immediately preceding year as reduced by depreciation actually allowed in relation to the said previous year [*Explanation 2* to section 43(6)].
- (v) Where in any previous year any asset forming part of a block of assets is transferred by demerged company to the resulting company, the written down value of the block of assets of the demerged company for the immediately preceding year shall be reduced by the written down value of the assets transferred to the resulting company [*Explanation 2A* to section 43(6)].
- (vi) Where any asset forming part of a block of assets is transferred by a demerged company to the resulting company, the written down value of the block of assets in the case of resulting company shall be the written down value of the transferred assets of the demerged company immediately before the demerger [*Explanation 2B* to section 43(6)].
- (vii) The actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion [*Explanation 2C* to section 43(6)].
- (viii) Where any asset forming part of a block of assets is transferred in any previous year by a recognised stock exchange in India to a company under a scheme for corporatisation approved by SEBI, the written down value of the block shall be the written down value of the transferred assets immediately before the transfer [*Explanation 5* to section 43(6)].

(ix) Depreciation provided in the books of account deemed to be depreciation actually allowed [*Explanation 6* to section 43(6)]

Section 32(1)(ii) provides that depreciation shall be allowed at the prescribed percentage on the written down value (WDV) of any block of assets. Section 43(6)(b) provides that written down value in the case of assets acquired before the previous year means the actual cost to the assessee less all depreciation actually allowed to him under the Income-tax Act, 1961.

Persons who were exempt from tax were not required to compute their income under the head "Profits and gains of business or profession". However, when the exemption is withdrawn subsequently, such persons became liable to income-tax and hence, were required to compute their income for income-tax purposes. In this regard, a question arises as to the basis on which depreciation is to be allowed under the Income-tax Act, 1961 in respect of assets acquired during the years when the person was exempt from tax.

Explanation 6 to section 43(6) provides that,-

- (a) the actual cost of an asset has to be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;
- (b) the total amount of depreciation on such asset provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under the Income-tax Act, 1961 for the purposes of section 43(6);
- (c) the depreciation actually allowed as above has to be adjusted by the amount of depreciation attributable to such revaluation.

(x) *Explanation 7* provides that in cases of 'composite income', for the purpose of computing written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire composite income of the assessee is chargeable under the head "Profits and Gains of business or profession". The depreciation so computed shall be deemed to have been "actually allowed" to the assessee.

For instance, Rule 8 prescribes the taxability of income from the manufacture of tea. Under the said rule, income derived from the sale of tea grown and manufactured by seller shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax. If the turnover is, say, ₹ 20 lakh, the depreciation ₹ 1 lakh and other expenses ₹ 4 lakh, then the income would be ₹ 15 lakh. Business income would be ₹ 6 lakh (being 40% of ₹ 15 lakh). As per earlier Court decisions, only the depreciation "actually allowed" i.e., ₹ 40,000, being 40% of ₹ 1 lakh, has to be deducted to arrive at the written down value. The ambiguity in this case has arisen on account of the interpretation of the meaning of the phrase "actually allowed" used in section 43(6)(b). However, the correct legislative intent is that the WDV is required to be computed by deducting the full depreciation attributable to composite income i.e. ₹ 1 lakh in this case. *Explanation 7* clarifies this legislative intent.

(xi) The written down value of any block of assets, may be reduced to nil for any of the following reasons:

(a) The moneys receivable by the assessee in regard to the assets sold or otherwise transferred during the previous year together with the amount of scrap value may exceed the written down value at the beginning of the year as increased by the actual cost of any new asset acquired, or

(b) All the assets in the relevant block may be transferred during the year.

(8) Rates of depreciation - All assets have been divided into four main categories and rates of depreciation as prescribed by Rule 5(1) are given below:

PART A TANGIBLE ASSETS

I Buildings

Block 1.	Buildings (other than covered by sub-item (3) below) which are used mainly for residential purposes	5%
Block 2.	Buildings which are not used mainly for residential purposes and not covered by sub-items (1) above and (3) below	10%
Block 3.	Buildings acquired on or after the 1st September, 2002 For installing machinery and plant forming part of water supply project or water treatment system and which is put to use for the purpose of business of providing infrastructure facilities under clause (i) of sub-section (4) of section 80-IA	100%
Block 4.	Purely temporary erections such as wooden structures	100%

II Furniture and Fittings

Block 1.	Furniture and fittings including electrical fittings	10%
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III Plant & Machinery

Block 1.	Motors buses, motor lorries, motor taxis used in the business of running them on hire	30%
Block 2.	Aeroplanes, aeroengines	40%
Block 3.	Specified air, water pollution control equipments, solid waste control equipment and solid waste recycling and resource recovery systems	100%
Block 4.	Energy Saving Devices (as specified)	80%
Block 5.	Motor cars other than those used in a business of running them on hire, acquired or put to use on or after 1-4-1990.	15%
Block 6.	Computers including computer software	60%
Block 7.	Annual publications owned by assesseees carrying on a profession	100%
Block 8.	Books owned by assesseees carrying on business in running lending libraries	100%

Block 9.	Books, other than annual publications, owned by assesseees carrying on a profession	60%
Block 10.	Plant & machinery (General rate)	15%
IV Ships		
Block 1.	Ocean-going ships	20%
Block 2.	Vessels ordinarily operating on inland waters not covered by sub-item (3) below	20%
Block 3.	Speed boats operating on inland water	20%
PART B INTANGIBLE ASSETS		
	Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature	25%

Students should refer to Income-tax Rules, 1962 for the detailed classification of assets under Rule 5(1) and the rates applicable thereto.

Note – (1) New commercial vehicles acquired on or after 1.1.2009 but before 1.10.2009 and put to use before 1.10.2009 for the purposes of business or profession" would be classified under the head MACHINERY AND PLANT and would be eligible for depreciation at the rate of 50%.

(2) Windmills and any specially designed devices which run on windmills installed on or before 31.3.2012 would be eligible for depreciation@80%. Likewise, any special devices including electric generators and pumps running on wind energy installed on or before 31.3.2012 would be eligible for depreciation@80%. In respect of windmills and any specially designed devices running on windmills installed on or after 1.4.2012 and any special devices including electric generators and pumps running on wind energy installed on or after 1.4.2012, the rate of depreciation is 15%.

(9) Increased rate of depreciation for certain assets [Rule 5(2)] - Any new machinery or plant installed to manufacture or produce any article or thing by using any technology or other know-how developed in a laboratory owned or financed by the Government or a laboratory owned by a public sector company or a University or an institution recognized by the Secretary, Department of Scientific and Industrial Research, Government of India shall be treated as a part of the block of assets qualifying for depreciation@40%.

Conditions to be fulfilled:

1. The right to use such technology to manufacture such article has been acquired from the owner of such laboratory or any person deriving title from such owner.
2. The return filed by the assessee for any previous year in which the said machinery is acquired, should be accompanied by a certificate from the Secretary, Department of Scientific and Industrial Research, Government of India to the effect that such article is manufactured by using such technology developed in such laboratory or such article has been invented in that laboratory.

3. The machinery or plant is not used for the purpose of business of manufacture or production of any article or thing specified in the Eleventh schedule.

The depreciation ordinarily allowable to an assessee in respect of any block of assets shall be calculated at the above specified rates on the WDV of such block of assets as are used for the purposes of the business or profession of the assessee at any time during the previous year.

(10) Carry forward and set off of depreciation [Section 32(2)] - Section 32(2) provides for carry forward of unabsorbed depreciation. Where, in any previous year the profits or gains chargeable are not sufficient to give full effect to the depreciation allowance, the unabsorbed depreciation shall be added to the depreciation allowance for the following previous year and shall be deemed to be part of that allowance. If no depreciation allowance is available for that previous year, the unabsorbed depreciation of the earlier previous year shall become the depreciation allowance of that year. The effect of this provision is that the unabsorbed depreciation shall be carried forward indefinitely till it is fully set off.

However, in the order of set-off of losses under different heads of income, effect shall first be given to business losses and then to unabsorbed depreciation.

The provisions in effect are as follows:

- Since the unabsorbed depreciation now falls part of the current year's depreciation, it can be set off against any other head of income.
- The unabsorbed depreciation can be carried forward for indefinite number of previous years.
- Set off will be allowed even if the same business to which it relates is no longer in existence in the year in which the set off takes place.

Current depreciation to be deducted first - The Supreme Court, in *CIT v. Mother India Refrigeration (P.) Ltd.* [1985] 23 Taxman 8, has categorically held that current depreciation must be deducted first before deducting the unabsorbed carried forward business losses of the earlier years in giving set off while computing the total income of any particular year.

Illustration 1

A newly qualified Chartered Accountant Mr. Dhaval, commenced practice and has acquired the following assets in his office during F.Y. 2014-15 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y. 2015-16:

Sl. No.	Description	Date of acquisition	Date when put to use	Amount ₹
1.	Computer	27 Sept., 14	1 Oct., 14	35,000
2.	Computer software	2 Oct., 14	4 Oct., 14	8,500
3.	Computer printer	2 Oct., 14	2 Oct., 14	12,500
4.	Books (of which books being annual publications are of ₹ 12,000)	1 Apr., 14	1 Apr., 14	13,000

5.	Office furniture (Acquired from a practising C.A.)	1 Apr., 14	1 Apr., 14	3,00,000
6.	Laptop	26 Sep., 14	4 Oct., 14	43,000

Solution**Computation of depreciation allowable for A.Y.2015-16**

	Asset	Rate	Depreciation
Block 1	Furniture	10%	30,000
Block 2	Plant (Computer, computer software, laptop, printers & books)	60%	44,550
Block 3	Plant (Books)	100%	12,000
Total depreciation allowable			86,550

Notes:**1. Computation of depreciation**

Block of Assets	₹
Block 1: Furniture – [Rate of depreciation - 10%] Put to use for more than 180 days [₹ 3,00,000@10%]	30,000
Block 2: Plant [Rate of depreciation - 60%] (a) Computer (put to use for more than 180 days) [₹ 35,000 @ 60%] (b) Computer Printer (put to use for more than 180 days) [₹ 12,500 @ 60%] (c) Laptop (put to use for less than 180 days) [₹ 43,000 @ 30%] (d) Computer Software (put to use for less than 180 days) [₹ 8,500@ 30%] (e) Books (other than annual publications) (Put to use for more than 180 days) [₹ 1,000 @ 60%]	21,000 7,500 12,900 2,550 600
	44,550
Block 3: Plant [Rate of depreciation - 100%] Books (being annual publications) put to use for more than 180 days [₹ 12,000@100%]	12,000

2. Where an asset is acquired by the assessee during the previous year and is put to use for the purposes of business or profession for a period of less than 180 days, the deduction on account of depreciation would be restricted to 50% of the prescribed rate. In this case, since Mr. Dhaval commenced his practice in the P.Y.2014-15 and acquired

the assets during the same year, the restriction of depreciation to 50% of the prescribed rate would apply to those assets which have been put to use for less than 180 days in that year, namely, laptop and computer software.

Illustration 2

Gamma Ltd. was incorporated on 1.1.2014 for manufacture of tyres and tubes for motor vehicles. The manufacturing unit was set up on 1.5.2014. The company commenced its manufacturing operations on 1.6.2014. The total cost of the plant and machinery installed in the unit is ₹ 120 crore. The said plant and machinery included second hand plant and machinery bought for ₹ 20 crore and new plant and machinery for scientific research relating to the business of the assessee acquired at a cost of ₹ 15 crore.

Compute the amount of depreciation allowable under section 32 of the Income-tax Act, 1961 in respect of the assessment year 2015-16.

Solution

Computation of depreciation allowable for the A.Y.2015-16 in the hands of Gamma Ltd.

Particulars	₹ in crore	
Total cost of plant and machinery	120.00	
Less: Used for Scientific Research (Note 1)	<u>15.00</u>	
	105.00	
Normal Depreciation at 15% on ₹ 105 crore		15.75
Additional Depreciation:		
Cost of plant and machinery	120.00	
Less: Second hand plant and machinery (Note 2) 20.00		
Plant and machinery used for scientific research, the whole of the actual cost of which is allowable as deduction under section 35(2)(ia) (Note 2) <u>15.00</u>	<u>35.00</u>	
	85.00	
Additional Depreciation at 20%		<u>17.00</u>
Depreciation allowable for A.Y.2015-16		<u>32.75</u>

Notes:

- As per section 35(2)(iv), no depreciation shall be allowed in respect of plant and machinery purchased for scientific research relating to assessee's business, since deduction is allowable under section 35 in respect of such capital expenditure.
- As per section 32(1)(ia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged in, *inter alia*, the business of manufacture or production of any article or thing, at the rate of 20% of the actual cost of such machinery or plant.

However, additional depreciation shall not be allowed in respect of, inter alia, –

- (i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;
- (ii) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profit and gains of business or profession" of any one previous year.

In view of the above provisions, additional depreciation cannot be claimed in respect of –

- (i) Second hand plant and machinery;
- (ii) New plant and machinery purchased for scientific research relating to assessee's business in respect of which the whole of the capital expenditure can be claimed as deduction under section 35(1)(iv) read with section 35(2)(ia).

Illustration 3

Lights and Power Ltd. engaged in the business of generation of power, furnishes the following particulars pertaining to P.Y.2014-15. Compute the depreciation allowable under section 32 for A.Y.2015-16, while computing its income under the head "Profits and gains of business or profession". The company has opted for the depreciation allowance on the basis of written down value.

	Particulars	₹
1.	Opening Written down value of Plant and Machinery (15% block) as on 01.04.2014 (Purchase value ₹ 8,00,000)	5,78,000
2.	Purchase of second hand machinery (15% block) on 29.12.2014 for business purpose	2,00,000
3.	Machinery Y (15% block) purchased and installed on 12.07.2014 for the purpose of power generation	8,00,000
4.	Acquired and installed for use a new air pollution control equipment on 31.7.2014	2,50,000
5.	New air conditioner purchased and installed in office premises on 8.9.2014	3,00,000
6.	New machinery Z (15% block) acquired and installed on 23.11.2014 for the purpose of generation of power	3,25,000
7.	Sale value of an old machinery X, sold during the year (Purchase value ₹ 4,80,000, WDV as on 01.04.2014 ₹ 3,46,800)	3,10,000

Answer

Computation of depreciation allowance under section 32 for the A.Y. 2015-16

Particulars	₹	Plant and Machinery (15%) (₹)	Plant and Machinery (100%) (₹)
Opening WDV as on 01.04.2014		5,78,000	-

4.90 Income-tax

<i>Add:</i> Plant and Machinery acquired during the year			
- Second hand machinery	2,00,000		
- Machinery Y	8,00,000		
- Air conditioner for office	3,00,000		
- Machinery Z	<u>3,25,000</u>	16,25,000	
- Air pollution control equipment		<u>-</u>	<u>2,50,000</u>
		22,03,000	2,50,000
<i>Less:</i> Asset sold during the year		<u>3,10,000</u>	<u>Nil</u>
Written down value before charging depreciation		<u>18,93,000</u>	<u>2,50,000</u>
Normal depreciation			
100% on air pollution control equipment		-	2,50,000
Depreciation on plant and machinery put to use for less than 180 days@ 7.5% (i.e., 50% of 15%)			
- Second hand machinery (₹ 2,00,000 × 7.5%)	15,000		
- Machinery Z (₹ 3,25,000 × 7.5%)	<u>24,375</u>	39,375	
15% on the balance WDV being put to use for more than 180 days (₹ 13,68,000 × 15%)		2,05,200	
Additional depreciation			
- Machinery Y (₹ 8,00,000 × 20%)	1,60,000		
- Machinery Z (₹ 3,25,000 × 10%)	<u>32,500</u>	<u>1,92,500</u>	<u>Nil</u>
Total depreciation		<u>4,37,075</u>	<u>2,50,000</u>

Notes:

- (1) Power generation equipments qualify for claiming additional depreciation in respect of new plant and machinery.
- (2) Additional depreciation is not allowed in respect of second hand machinery.
- (3) No additional depreciation is allowed in respect of office appliances. Hence, no depreciation is allowed in respect of air conditioner installed in office premises.
- (4) Additional depreciation is not allowed in respect of an asset whose actual cost is allowed as deduction in computing the income chargeable under the head "Profit and Gains of business or profession". It is presumed that the new air pollution control equipment installed is eligible for 100% depreciation. Therefore, no additional depreciation is allowed in respect of the same.

(11) **Building, machinery, plant and furniture not exclusively used for business purpose [Section 38(2)]** – Where any building, plant and machinery, furniture is not exclusively used for the

purposes of business or profession, the deduction on account of expenses on account of current repairs to the premises, insurance premium of the premises, current repairs and insurance premium of machinery, plant and furniture and depreciation in respect of these assets shall be restricted to a fair proportionate part thereof, which the Assessing Officer may determine having regard to the user of such asset for the purposes of the business or profession.

(12) Balancing Charge – Section 41(2) provides for the manner of calculation of the amount which shall be chargeable to income-tax as income of the business of the previous year in which the monies payable for the building, machinery, plant or furniture on which depreciation has been claimed under section 32(1)(i), i.e. in the case of power undertakings, is sold, discarded, demolished or destroyed. The balancing charge will be the amount by which the moneys payable in respect of such building, machinery, plant or furniture, together with the amount of scrap value, if any, exceeds the written down value. However, the amount of balancing charge should not exceed the difference between the actual cost and the WDV. The tax shall be levied in the year in which the moneys payable become due.

The *Explanation* below section 41(2) makes it clear that where the moneys payable in respect of the building, machinery, plant or furniture referred to in section 41(2) become due in a previous year in which the business, for the purpose of which the building, machinery, plant or furniture was being used, is no longer in existence, these provisions will apply as if the business is in existence in that previous year.

(iv) Deduction for investment in new plant and machinery [Section 32AC]

Existing Provisions [Effective from A.Y.2014-15]:

(i) Section 32AC was inserted by the Finance Act, 2013 w.e.f. A.Y.2014-15 to provide a tax incentive by way of investment allowance to encourage huge investment in plant or machinery.

(ii) As per section 32AC(1), a **manufacturing company** is entitled to deduction@15% of aggregate investment in new plant and machinery if it is -

(a) engaged in the business of manufacture of an article or thing; and

(b) invests a sum of more than ₹ 100 crore in new plant or machinery during the period beginning from 1st April, 2013 and ending on 31st March, 2015.

(iii) For A.Y. 2014-15, a manufacturing company was entitled to deduction of 15% of aggregate amount of actual cost of new assets acquired and installed during the financial year 2013-14, if the aggregate cost of such assets exceed ₹ 100 crore.

For A.Y.2015-16, a deduction of 15% of aggregate amount of actual cost of new assets, acquired and installed during the period beginning on 1st April, 2013 and ending on 31st March, 2015, as reduced by the deduction allowed, if any, for A.Y. 2014-15.

(iv) The deduction@15% under this section is in addition to the depreciation and additional depreciation allowable under section 32(1). Further, the deduction under section 32AC would not be reduced to arrive at the written down value of plant and machinery.

Additional benefit [Under sub-section (1A) inserted in section 32AC by Finance (No.2) Act, 2014, with effect from A.Y.2015-16]

(v) This year, considering that growth of the manufacturing sector is critical for employment generation and development of an economy, the deduction available under section 32AC has been extended for investment made in plant and machinery up to 31.03.2017.

Further, in order to rationalize the existing provisions of section 32AC and also to make medium size investments in plant and machinery eligible for deduction, new sub-section (1A) has been inserted to provide that deduction under section 32AC would be available if the company, on or after 1st April, 2014, invests more than ₹ 25 crore in plant and machinery in a previous year.

(vi) Companies which are eligible to claim deduction under the existing combined threshold limit of "more than ₹ 100 crore" for investment made in previous years 2013-14 and 2014-15 shall continue to be eligible to claim deduction under section 32AC(1), even if its investment in the year 2014-15 is below the new threshold limit of investment of ₹ 25 crore.

(vii) "New plant or machinery" does not include—

- (1) any plant or machinery which before its installation by the assessee was used either within or outside India by any other person;
- (2) any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;
- (3) any office appliances including computers or computer software;
- (4) any vehicle;
- (5) ship or aircraft; or
- (6) any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.

(viii) The new plant and machinery in respect of which deduction has been claimed under section 32AC cannot be sold or otherwise transferred for a period of 5 years from the date of installation. If it is sold or transferred within this period, the deduction allowed earlier would be deemed as income chargeable to tax under the head "Profits and gains of business or profession" of the previous year in which such new plant and machinery is sold or otherwise transferred. This would be in addition to the taxability of gains on transfer of such plant and machinery.

In case of amalgamation or demerger, this restriction would continue to apply to the amalgamated company or resulting company, as the case may be, as it would have applied to the amalgamating or demerged company.

Illustration 4

Compute the admissible investment allowance under section 32AC for A.Y.2014-15 and A.Y.2015-16 in each of the following cases -

Company	Investment in new plant and machinery (₹ in crore)	
	P.Y.2013-14	P.Y.2014-15
A Ltd.	80	22
B Ltd.	70	25
C Ltd.	60	30
D Ltd.	75	25
E Ltd.	105	15
F Ltd.	70	30
G Ltd.	70	40

Solution

Company	Investment in new plant and machinery (₹ in crore)		Deduction under section 32AC (₹ in crore)		Under sub-section
	P.Y.2013-14	P.Y.2014-15	A.Y.2014-15	A.Y.2015-16	
A Ltd.	80	22	Nil	15.30	(1)
B Ltd.	70	25	Nil	Nil	-
C Ltd.	60	30	Nil	4.50	(1A)
D Ltd.	75	25	Nil	Nil	-
E Ltd.	105	15	15.75	2.25	(1)
F Ltd.	70	30	Nil	4.50	(1A)
G Ltd.	70	40	Nil	16.50	(1)

Illustration 5

B Ltd., a company engaged in the business of manufacture of sports equipments, furnishes the following particulars pertaining to P.Y.2013-14 and P.Y.2014-15. Compute the depreciation allowable under section 32 as well as the deduction allowable under section 32AC for A.Y.2014-15 and A.Y.2015-16, while computing its income under the head "Profits and gains of business or profession". Also, compute the written down value of plant and machinery as on 1.4.2014 and 1.4.2015.

4.94 Income-tax

	<i>Particulars</i>	<i>₹ in crore</i>
1.	<i>Written down value of plant and machinery (15% block) as on 01.04.2013</i>	25.00
2.	<i>Sold plant and machinery on 20.5.2013 (15% block)</i>	4.00
3.	<i>Purchase of second hand machinery (15% block) on 29.5.2013 for business purpose (the machinery was put to use immediately)</i>	12.00
4.	<i>Purchased new computers (60% block) on 8.11.2013 for office</i>	0.40
5.	<i>Acquired and installed new plant and machinery (15% block) on 31.7.2013 (₹ 50 crore) and on 31.10.2013 (₹ 40 crore)</i>	90.00
6.	<i>New air conditioners purchased and installed in office premises on 30.6.2013</i>	0.15
7.	<i>Acquired and installed new plant and machinery (15% block) on 2.4.2014</i>	15.00

Solution

Computation of depreciation allowance under section 32 for the A.Y. 2014-15

Particulars	Plant and Machinery (15%)	Plant and Machinery (60%)
	(₹ in crore)	
WDV as on 01.04.2013	25.00	-
<i>Add: Plant and Machinery acquired during the year</i>		
- Second hand machinery	12.00	
- New plant and machinery	90.00	
- Air conditioner installed in office	<u>0.15</u>	
	102.15	
Computers acquired during the year	-	<u>0.40</u>
	127.15	0.40
<i>Less: Asset sold during the year</i>	<u>4.00</u>	<u>Nil</u>
Written down value before charging depreciation	123.15	0.40
<i>Less: Depreciation for the P.Y.2013-14 (See Note 1 below)</i>	<u>29.47</u>	<u>0.12</u>
WDV as on 1.4.2014	<u>93.68</u>	<u>0.28</u>

Note 1 : Computation of depreciation for the P.Y.2013-14		(₹ in crore)	
Normal depreciation			
Depreciation@30% on computers put to use for less than 180 days (50% of 60% × 0.40 crore)		-	0.12
Depreciation on plant and machinery (15% block) (40 × 7.5%) + [(123.15-40) × 15%]		15.47	
Additional depreciation			
- New plant and machinery installed on 31.7.2013 (₹ 50 crore × 20%)	10		
- on 31.10.2013 (₹ 40 crore × 10%)	4	14.00	Nil
Total depreciation		29.47	0.12

Note – For the A.Y.2014-15, the company would not be entitled for investment allowance under section 32AC since the investment in new plant and machinery acquired and installed during the year is only ₹ 90 crores (i.e., less than ₹ 100 crores). Investment in second hand plant and machinery and air-conditioners and computers installed in office would not be eligible for deduction under section 32AC or additional depreciation under section 32(1)(iia).

Computation of depreciation allowance under section 32 for the A.Y. 2015-16

Particulars	Plant and Machinery (15%)	Plant and Machinery (60%)
	(₹ in crore)	
WDV as on 1.4.2014	93.68	0.28
Add: Plant and Machinery acquired during the year	15.00	-
	108.68	0.28
Less: Asset sold during the year	Nil	Nil
Written down value (before charging depreciation)	108.68	0.28
Less: Depreciation for the P.Y.2014-15 @15% and 60%, respectively	16.30	0.17
Additional depreciation@20% on 15 crore	3.00	
WDV as on 1.4.2015	89.38	0.11

Computation of deduction under section 32AC for the A.Y.2015-16

Particulars	(₹ in crore)
New plant and machinery acquired and installed during the P.Y.2013-14	90
New plant and machinery acquired and installed during the P.Y.2014-15	<u>15</u>
Aggregate investment in new plant and machinery during the period from 1.4.2013 to 31.3.2015	<u>105</u>
Investment allowance@15% of ₹ 105 crore	15.75
Less: Deduction allowed under section 32AC during the A.Y.2014-15	<u>Nil</u>
Deduction under section 32AC for the A.Y.2015-16	<u>15.75</u>

Note - The company would be eligible for deduction under section 32AC in the P.Y.2014-15, since the aggregate investment in new plant and machinery from 1.4.2013 to 31.3.2015 has exceeded ₹ 100 crore.

(v) Tea Development Account/Coffee Development Account/Rubber Development Account [Section 33AB]

(1) Where an assessee carrying on the business of growing and manufacturing tea or coffee or rubber in India has, before the expiry of six months from the end of the previous year or before the due date of furnishing the return of income, whichever is earlier, (i) deposited with a National Bank any amount in a special account maintained by the assessee with that Bank in accordance with a scheme approved by Tea Board or Coffee Board or Rubber Board, or (ii) deposited any amount to be known as Deposit Account opened by the assessee in accordance with the scheme framed by the Tea Board or Coffee Board or Rubber Board, as the case may be, with the previous approval of the Central Government, the assessee shall be allowed a deduction of :

- (a) A sum equal to the aggregate of the deposits made or
 - (b) 40% of the profits of such business computed under the head 'Profits and gains of business or profession' before making any deduction under this section,
- whichever is less.

(2) The above deduction will be allowed before the setting off of brought-forward loss under section 72.

(3) Where the assessee is a firm or any association of persons or any body of individuals the deduction under this section shall not be allowed in the computation of the income of any partner or member of such firm, AOP or BOI.

(4) This deduction shall not be allowed unless the accounts of such business of the assessee for the previous year have been audited by a chartered accountant and the assessee furnishes along with his return of income the report of such audit in the prescribed form duly signed and verified by such accountant.

(5) However, where the assessee is required by any other law to get his accounts audited it shall be sufficient compliance with the provision of this section if such assessee gets the accounts of such business audited under any such law and furnishes the report of the audit and a further report in the prescribed form under this section.

(6) Any amount standing to the credit of the assessee in the special account cannot be withdrawn except for the purposes specified in the scheme, or, as the case may be, in the deposit scheme.

The above amount can also be withdrawn in the following circumstances:

- (a) Closure of business
- (b) Death of an assessee
- (c) Partition of HUF
- (d) Dissolution of a firm
- (e) Liquidation of a company.

(7) Where the sum standing to the credit of the assessee in the Special account or in the Deposit account is released by the National Bank or is withdrawn by the assessee from the Deposit account and is utilised for the purchase of:

- (a) Any machinery or plant installed in any office premises or residential accommodation including a guest house.
- (b) Any office appliances (other than computers)
- (c) Any machinery or plant the whole of whose actual cost is allowed as deduction by way of depreciation or otherwise in computing the business income.
- (d) Any new machinery or plant installed for production of any XI Schedule item, the whole of such amount so utilised will be treated as taxable profits of that year and taxed accordingly.

(8) Where any amount is withdrawn by the assessee from the special account during any previous year on the closure of his business or dissolution of a firm, the whole of such withdrawal shall be deemed to be the profits and gains of business of that previous year and shall be chargeable to tax as the income of that previous year, as if the business had not closed or the firm had not been dissolved.

(9) Where any amount standing to the credit of the assessee in the special account is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme, such expenditure shall not be allowed in computing the business income.

(10) Where any amount in the special account which is released during any previous year by the National Bank for being utilised by the assessee for the purposes of such business in accordance with the scheme is not so utilised within that previous year, the unutilised amount shall be deemed to be profits and gains and chargeable to income-tax as the income of that previous year.

However, where such amount is released during the previous year at the closing of the

account on the death of the assessee, partition of a HUF or liquidation of a company, the above restriction will not apply.

(11) Where an asset acquired in accordance with the scheme is sold or otherwise transferred in any previous year by the assessee to any person at any time before the expiry of 8 years from the end of the previous year in which it was acquired, such portion of the cost equal to the deduction allowed under this section shall be deemed to be profits of the previous year in which the asset is sold or transferred and shall be chargeable to income-tax as the income of that previous year.

However, the above restriction will not apply in the following cases :

- (i) Where the asset is sold or otherwise transferred to Government, local authority, statutory corporation or a Government company.
- (ii) Where the sale or transfer is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as result of which the firm sells or otherwise transfers any asset to the company and the scheme continues to apply to the company in the same manner as applicable to the firm. Further, all the properties of the firm relating to the business or profession immediately before the succession should become the liabilities of the company and all the shareholders of the company should have been partners of the firm immediately before the succession.

(12) The Central Government has the power to direct that the deduction allowable under this section shall not be allowed after a specified date.

(13) "National Bank" means the National Bank for Agricultural and Rural Development (NABARD).

(vi) Site Restoration Fund [Section 33ABA] – (1) This section provides for a deduction in the computation of the taxable profits in the case of an assessee carrying on business of prospecting for, or extraction or production, of petroleum or natural gas or both in India and in relation to which the Central Government has entered into an agreement with such assessee for such business.

(2) It provides that where the assessee has during the previous year -

- (i) deposited any sum with the State Bank of India in a special account maintained by the assessee with that bank in accordance with the scheme approved in this behalf by the Government of India in the Ministry of Petroleum and Natural Gas (hereinafter referred to as the Site Restoration Account), or
- (ii) deposited any amount in an account opened by the assessee for the purposes specified in a scheme framed by the said Ministry,

the assessee shall be entitled to a deduction of —

- a sum equal to the sum deposited; or
- a sum equal to twenty per cent of its profits (as computed under the head "Profits and gains of business or profession" before making any deduction under the new section),

whichever is less.

(3) For this purpose, it is provided that any amount credited in the special account or Site Restoration Account by way of interest shall also be deemed to be a deposit.

(4) **Non-eligibility** - (i) Where such assessee is a firm or AOP or BOI, the deduction under this section will not be available in the computation of the income of any partner of the firm or the member of the AOP or BOI.

(ii) Where any deduction in respect of any amount deposited in the special account or Site Restoration Account has been allowed in any previous year, no deduction shall be allowed in respect of such amount in any other previous year.

(5) **Audit** - (i) Section 33ABA(2) provides that deduction under sub-section (1) shall not be admissible unless the accounts of the said business of the assessee for the previous year relevant to the assessment year have been audited by a chartered accountant and the assessee furnishes the report of such audit in the prescribed form along with the return.

(ii) Where the assessee is required by or under any other law to get his accounts audited, it will be sufficient compliance with the provisions of this sub-section if the assessee gets the accounts of the aforesaid business audited under any such law and furnishes the report of the audit and a further report in the prescribed form.

(6) **Withdrawal of deduction** - Any amount standing to the credit in the special account or the Site Restoration Account will not be allowed to be withdrawn except for the purposes specified in the scheme or in the deposit scheme.

No deduction shall be allowed in respect of any amount utilised for the purchase of the following items:

- (a) any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest house;
- (b) any office appliances (not being computers);
- (c) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head 'Profits and gains of business or profession' of any one previous year;
- (d) any new machinery or plant to be installed in an industrial undertaking for the purpose of the business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule.

(7) **Withdrawal on closure of account** - (i) Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is withdrawn on closure of the account during any previous year by the assessee, the amount so withdrawn from the account as reduced by the amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement referred to in section 42, shall be deemed to be the profits and gains of business or profession of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year.

(ii) Where any amount is withdrawn on closure of the account in a previous year in which the business carried on by the assessee is no longer in existence, these provisions will apply

as if the business is in existence in that previous year.

(8) Utilisation from scheme not available as a deduction - When any amount standing to the credit of the assessee in the special account or in the Site Restoration Account business is utilised by the assessee for the purpose of any expenditure in connection with such business in accordance with the scheme or the deposit scheme such expenditure will not be allowed in computing the income chargeable under the head 'Profits and gains of business or profession'.

(9) Consequences of non-utilisation - Where any amount is released in the previous year by the State Bank of India or is withdrawn from the Site Restoration Account and is not utilised in accordance with the scheme or the deposit scheme, the whole of such amount or the part thereof shall be deemed to be the profits and gains of business and accordingly chargeable to income-tax as income of that previous year. This sub-section will not apply in a case where such amount is released in the event of death of an assessee, partition of a Hindu undivided family or liquidation of a company. These circumstances are provided in clauses (b), (c) and (e) of section 33AB(3).

(10) Consequences of sale or transfer - Where any asset acquired in accordance with the scheme or the deposit scheme is sold or otherwise transferred in any previous year by the assessee before the expiry of eight years from the end of the previous year in which such assets were acquired, such part of the cost of such asset as is relatable to the deduction allowed under section 33ABA(1) shall be deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and shall accordingly be chargeable to income-tax as the income of that previous year.

This sub-section will not apply in the following cases:

- (a) where the asset is sold or otherwise transferred by the assessee to the Government, a local authority, a corporation established by or under a Central, State or Provincial Act or a Government company as defined in section 617 of the Companies Act, 1956; or
- (b) where the sale or transfer of the asset is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the scheme or the deposit scheme continues to apply to the company in the manner applicable to the firm, if the following conditions are satisfied;
 - (i) all the properties of the firm relating to the business or profession immediately before the succession become the properties of the company;
 - (ii) all the liabilities of the firm relating to the business or profession immediately before the succession become the liabilities of the company; and
 - (iii) all the shareholders of the company were partners of the firm immediately before the succession.

Specified period - The Central Government may, by notification in the Official Gazette, direct that the deduction allowable under this section will not be allowed after such date as may be specified in such notification.

(vii) Reserves for Shipping Business [Section 33AC]: The tonnage tax scheme, introduced by insertion of Chapter XII-G in the Income-tax Act, 1961, provides for special provisions relating to taxation of income of shipping companies. Consequently, no deduction under section 33AC is allowable from A.Y. 2005-06, where a shipping company has opted for the tonnage tax scheme.

(viii) Expenditure on Scientific Research [Section 35]: This section allows a deduction in respect of any expenditure on scientific research related to the business of assessee. The expression 'scientific research' as defined in section 43(4)(i) means activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries. A reference to expenditure incurred on scientific research would include all expenditure incurred for the prosecution or the provision of facilities for the prosecution of scientific research but does not include any expenditure incurred in the acquisition of rights in or arising out of scientific research. In particular, a reference to scientific research related to a business or a class of business would include (i) any scientific research which may lead to or facilitate an extension of that business or all the business of that class, as the case may be; (ii) any scientific research of a medical nature which has a special relation to the welfare of the workers employed in that business or all the business of that class, as the case may be.

(1) The deduction allowable under this section consists of -

(i) Revenue Expenditure:

(a) Any revenue expenditure incurred by the assessee himself on scientific research related to his business. Expenditure incurred within 3 years immediately preceding the commencement of the business on payment of salary to research personnel engaged in scientific research related to his business carried on by the taxpayer or on material inputs for such scientific research will be allowed as deduction in the year in which the business is commenced. The deduction will be limited to the amount certified by the prescribed authority.

(b) An amount equal to $1\frac{3}{4}$ times of any sum paid to a university, college or other institution or research association which has as its object, the undertaking of scientific research to be used for scientific research provided that the university, college, institution or association is approved for this purpose by the Central Government by notification in the Official Gazette.

The scope of the above deduction has been extended to cover expenditure on sponsored research carried out in the in-house research and development facilities of public companies. For the purpose, the expression "public sector company" means Government company as defined in section 617 of the Companies Act, 1956.

The payments so made to such institutions would be allowable irrespective of whether (i) the field of scientific research is related to the assessee's business or not, and (ii) the payment is of a revenue nature or of a capital nature.

(c) A sum equal to $1\frac{1}{4}$ times of any amount paid to a company to be used by it for scientific research [Clause (iia) of section 35(1)]

However, such deduction would be available only if the company is registered in India and has

as its main object the scientific research and development. Further, it should be approved by the prescribed authority and should fulfill the other prescribed conditions.

A company approved under section 35(1)(ia) will not be entitled to claim weighted deduction of 200% under section 35(2AB). However, it can continue to claim deduction under section 35(1)(i) in respect of the revenue expenditure incurred on scientific research.

(d) A sum equal to 1¼ times of any amount paid to a research association which has as its object the undertaking of research in social science or statistical research or to a university, college or other institution approved by the Central Government by notification in the Official Gazette to be used for research in any social science or statistical research.

(e) The applicant association, university, college or other institution shall be approved in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed. Such association, university, college or other institution should be notified in the Official Gazette by the Central Government.

(f) The deduction would be available only if such association, university, college or other institution is for the time being approved in accordance with the guidelines, in the manner and subject to such conditions as may be prescribed.

(g) Further, it has been clarified that the deduction to which an assessee (i.e. donor) is entitled on account of payment of any sum to a research association or university or college or other institution, shall not be denied merely on the ground that subsequent to payment of such sum by the assessee, the approval granted to any of the aforesaid entities is withdrawn.

(ii) **Capital Expenditure:** Any expenditure of a capital nature related to the business carried on by the assessee would be deductible in full in the previous year in which it is incurred.

Capital expenditure prior to commencement of business - The *Explanation* added to sub-section (2) specifically provides that where any capital expenditure has been incurred prior to the commencement of the business the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business shall be deemed to have been incurred in the previous year in which the business is commenced. Consequently, any capital expenditure incurred within three years before the commencement of business will rank for deduction as expenditure for scientific research incurred during the previous year.

Expenditure on land disallowed - No deduction will be allowed in respect of capital expenditure incurred on the acquisition of any land after 29-2-1984 whether the land is acquired as such or as part of any property.

For the above purpose the expression 'land' would include any interest in land and it shall be deemed to be acquired on the date on which the document purporting to transfer the land is registered under the Registration Act, 1908 and where the possession of any land has been obtained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882, on the date on which such possession was obtained.

(2) If any question arises under this section as to whether, and if so, to what extent, any activity constitutes, or any asset is being used, for scientific research, the Board shall refer the

question to—

- (a) the Central Government, when such question relates to any activity under clauses (ii) and (iii) of sub-section (1) i.e. any scientific research, or any research in social science or statistical research carried on by a university, college or institution approved for this purpose, and its decision shall be final;
- (b) the prescribed authority, when such question relates to any activity other than the activity specified in clause (a) above whose decision shall be final.

(3) Carry forward of deficiency - Capital expenditure incurred on scientific research which cannot be absorbed by the business profits of the relevant previous year can be carried forward to the immediately succeeding previous year and shall be treated as the allowance for that year. In effect, this means that there is no time bar on the period of carry forward. It shall be accordingly allowable for that previous year.

(4) No depreciation - Section 35(2)(iv) clarifies that no depreciation will be admissible on any capital asset represented by expenditure which has been allowed as a deduction under section 35 whether in the year in which deduction under section 35 was allowed or in any other previous year.

(5) Approval by Central Government - The Central Government by notification in the Official Gazette will approve such research association, university, college or institution for the purpose of sections 35(1)(ii) and 35(1)(iii).

The research association, university or college or other institution referred to in section 35(1)(ii) or (iii) shall make an application in the prescribed form and manner to the Central Government for the purpose of grant of approval or continuance thereof under these clauses.

The Central Government may call for such documents (including audited annual accounts) or information from the research association etc. in order to satisfy itself about the genuineness of the activities of the research association.

Notification issued by the Central Government under these clauses shall at any time have effect for not more than three assessment years (including an assessment year or years commencing before the date on which such notification is issued), as may be specified in the Notification. This time limit is applicable in respect of a notification issued by the Central Government under clause (ii) or clause (iii) before 13.7.2006. Consequently, any notification issued on or after 13.7.2006 shall remain in force until approval granted to such entity is withdrawn.

In respect of an application received on or after 13.7.2006, every notification under clause (ii) or clause (iii) shall be issued or an order rejecting the application shall be passed before expiry of 12 months from the end of the month in which the application for approval was received by the Central Government.

(6) Application of section 41 - Section 41, *inter alia*, seeks to tax the profits arising on the sale of an asset representing expenditure of a capital nature on scientific research. Such an asset might be sold, discarded, demolished or destroyed, either after having been used for the purposes of business on the cessation of its use for the purpose of scientific research related to the business or without having been used for other purposes. In either case, tax liability

could arise. In the first case, where the asset is sold, etc., after having been used for the purposes of the business, the moneys payable in respect of such asset together with the amount of scrap value, if any, could be brought to charge under section 41(1) the provisions of which are wide enough to cover such situations and to bring to tax that amount of deductions allowed in earlier years. It may be noted that in such cases, the actual cost of the concerned asset under section 43(1) read with explanation would be nil and no depreciation would be allowed by virtue of section 35(2)(iv).

Where the asset representing expenditure of a capital nature on Scientific Research is sold without having been used for other purposes, then the case would come under section 41(3) and if the proceeds of sale together with the total amount of the deductions made under section 35 exceed the amount of capital expenditure, the excess or the amount of deduction so made, whichever is less, will be charged to tax as income of the business of the previous year in which the sale took place.

(7) Sum paid to National Laboratory, etc. [Section 35(2AA)]- Sub-section (2AA) of section 35 provides that any sum paid by an assessee to a National Laboratory or University or Indian Institute of Technology or a specified person for carrying out programmes of scientific research approved by the prescribed authority will be eligible for weighted deduction of 200% of the amount so paid.

No contribution which qualifies for weighted deduction under this clause will be entitled to deduction under any other provision of the Act.

The authority which will approve the National Laboratory will also approve the programmes and procedure. Such programmes and procedure will be specified in rules.

The prescribed authority can call for each document or information as it considers necessary to satisfy itself about the genuineness of scientific research activities of the National Laboratory applying for approval. The prescribed authority under Rules 6(3) to (7) is Secretary, Department of Scientific & Industrial Research/Director General (Income-tax Exemptions).

It has been clarified that the deduction to which an assessee is entitled on account of payment of any sum by him to a National Laboratory, University, Indian Institute of Technology or a specified person for the approved programme [referred to in sub-section (2AA) of section 35] shall not be denied to the donor-assessee merely on the ground that after payment of such sum by him, the approval granted to any of the aforesaid done-entities has been withdrawn.

'National Laboratory' means a scientific laboratory functioning at the national level under the aegis of the Indian Council of Agricultural Research, Indian Council of Medical Research or the Council of Scientific and Industrial Research, the Defence Research and Development Organisation, the Department of Electronics, the Department of Bio-Technology, or the Department of Atomic Energy and which is approved as a National Laboratory by the prescribed authority in the prescribed manner. 'Specified person' means a person who is approved by the prescribed authority.

(8) Company engaged in Business of Drugs, Electronic Equipments, etc. [Section 35(2AB)] : Where a company engaged in the business of bio-technology or in any business of manufacture or production of any article or thing, not being an article or thing specified in the

list of the Eleventh Schedule incurs any expenditure on scientific research on inhouse research and development facility as approved by the prescribed authority, a deduction of a sum equal to 200% of the expenditure will be allowed. Such expenditure should not be in the nature of cost of any land or building.

For this clause, "expenditure on scientific research" in relation to drugs and pharmaceuticals shall include expenditure incurred on clinical drug trial, obtaining approval from any state regulatory authority, and filing an application for a patent under the Patents Act, 1970.

No deduction will be allowed in respect of the above expenditure under any other provision of this Act.

No company will be entitled to this deduction unless it enters into an agreement with the prescribed authority for co-operation in such research and development facility and for audit of accounts maintained for that facility.

The prescribed authority shall submit its report in relation to the approval of the said facility to the Director General in such form and within such time as may be prescribed.

No deduction shall be allowed in respect of such expenditure incurred after 31-3-2017.

(9) Weighted Deduction under section 35: A summary

The following table gives a summary of weighted deduction available under section 35 in respect of contributions made by any assessee to certain specified/ approved institutions:

Section	Contribution made to	Deduction (as a % of contribution made)
35(1)(ii)	Research Association for scientific research	175%
35(1)(ia)	Company for scientific research	125%
35(1)(iii)	Research association for research in social science or statistical research	125%
35(2AA)	National Laboratory / University / IIT	200%

Illustration 6

A Ltd. furnishes the following particulars for the P.Y.2014-15. Compute the deduction allowable under section 35 for A.Y.2015-16, while computing its income under the head "Profits and gains of business or profession".

	Particulars	₹
1.	Amount paid to Indian Institute of Science, Bangalore, for scientific research	1,00,000
2.	Amount paid to IIT, Delhi for an approved scientific research programme	2,50,000
3.	Amount paid to X Ltd., a company registered in India which has as its main object scientific research and development, as is approved by the prescribed authority	4,00,000

4.	<i>Expenditure incurred on in-house research and development facility as approved by the prescribed authority</i>	
(a)	<i>Revenue expenditure on scientific research</i>	3,00,000
(b)	<i>Capital expenditure (including cost of acquisition of land ₹ 5,00,000) on scientific research</i>	7,50,000

Solution**Computation of deduction under section 35 for the A.Y.2015-16**

Particulars	₹	Section	% of weighted deduction	Amount of deduction (₹)
Payment for scientific research				
Indian Institute of Science	1,00,000	35(1)(ii)	175%	1,75,000
IIT, Delhi	2,50,000	35(2AA)	200%	5,00,000
X Ltd.	4,00,000	35(1)(iia)	125%	5,00,000
Expenditure incurred on in-house research and development facility				
Revenue expenditure	3,00,000	35(2AB)	200%	6,00,000
Capital expenditure (excluding cost of acquisition of land ₹ 5,00,000)	2,50,000	35(2AB)	200%	<u>5,00,000</u>
Deduction allowable under section 35				<u>22,75,000</u>

(ix) **Expenditure for obtaining licence to operate telecommunication services [Section 35ABB]** - (1) Where any capital expenditure has been incurred for acquiring any right to operate telecommunication services and for which payment has actually been made to obtain a licence, a deduction will be allowed in equal annual instalments over the relevant previous years.

"Relevant previous years" means—

- in a case where the licence fee is actually paid before the commencement of the business to operate telecommunication services, the previous years beginning with the previous year in which such business commenced;
- in any other case, the previous years beginning with the previous year in which the licence fee is actually paid, and the subsequent previous year or years during which the licence, for which the fee is paid, shall be in force.

"Payment has actually been made" means the actual payment of expenditure irrespective of the previous year in which the liability for the expenditure was incurred according to the method of accounting regularly employed by the assessee.

- Moreover, any capital expenditure so incurred before the actual commencement of the business shall also be eligible for deduction under sub-section (1).

(3) Where the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are less than the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of the transfer, shall be allowed in respect of the previous year in which the licence is transferred.

(4) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) exceed the amount of the expenditure incurred remaining unallowed, so much of the excess as does not exceed the difference between the expenditure incurred to obtain the licence and the amount of such expenditure remaining unallowed shall be chargeable to income-tax as profits and gains of the business in the previous year in which the licence has been transferred.

Where the licence is transferred in a previous year in which the business is no longer in existence, the above provisions will apply as if the business is in existence in that previous year.

(5) Where the whole or any part of the licence is transferred and the proceeds of the transfer (so far as they consist of capital sums) are not less than the amount of expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed in respect of the previous year in which the licence is transferred or in any subsequent previous year.

(6) Where a part of the licence is transferred in a previous year, the proceeds of transfer will be subtracted from the expenditure remaining unallowed. Such remainder will be divided by the number of relevant previous years which have not expired at the beginning of the previous year during which the licence is transferred.

(7) Where in a scheme of amalgamation the amalgamating company sells or otherwise transfers the licence to the amalgamated company being an Indian company, the above provisions with regard to the chargeability of the surplus will not apply to the amalgamating company. Further, the provisions will apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.

(8) The said provisions relating to transfer of licence given in (iii), (iv) and (v) above shall not be applicable in the case of demerged company where the demerged company sells or transfers the licence to the resulting company (being an Indian company) and the provisions of the section allowing deduction of expenditure incurred for obtaining the licence shall be applicable to the resulting company as it would have applied to demerged company.

(9) Where a deduction is claimed and allowed for any previous year under sub-section (1) of the section 35ABB, then, no deduction on the capital expenditure so incurred shall be allowed by way of depreciation under sub-section (1) of section 32 in respect of acquiring any right to operate telecommunication services.

(x) Promotion of social and economic welfare [Section 35AC] – (1) Under this section, deduction will be allowed in computing profits of business or profession chargeable to tax, in respect of the expenditure incurred for an eligible project or scheme for promoting social and economic welfare or uplift of the public as may be specified by the Central Government on the recommendations of the "National Committee". For this purpose, 'National Committee' will be

the committee constituted by the Central Government from amongst persons of eminence in public life. Rules 11-F to 11-O deal with the National Committee for Promotion of Social and Economic Welfare and the guidelines for granting approval of associations and institutions and for recommending projects or schemes, for the purposes of this provision.

(2) The deduction will be allowed in case where the qualifying expenditure is either incurred by way of payment to a public sector company, a local authority or to an approved association or institution for carrying out any eligible project or scheme.

(3) However, companies will be allowed the deduction also in cases where expenditure is incurred by them directly on an eligible project or scheme.

(4) The claim for deduction under this section should be supported by a certificate obtained from the public sector company, local authority or approved association or institution as the case may be. Where the claim is in respect of expenditure directly incurred by a company on an eligible project or scheme, a certificate should be obtained from a Chartered Accountant.

(5) The deduction to which an assessee (i.e. the donor) is entitled on account of payment of any sum by him to a public sector company or a local authority or to an association or institution shall not be denied to the assessee merely on the ground that after payment of such sum by him, the approval granted to such association or institution has been withdrawn or the notification notifying the eligible project or scheme referred to in section 35AC has been withdrawn.

(6) The Committee can withdraw the approval to an association or institution if it is satisfied that the project or the scheme is not being carried on in accordance with all or any of the conditions subject to which approval was granted or if the association/institution has failed to furnish to the National Committee, after the end of each financial year, a progress report within the prescribed time in the prescribed form. The National Committee, should however, give a reasonable opportunity to the concerned association or institution of showing cause against the proposed withdrawal. Further, a copy of the order withdrawing the approval or notification should be forwarded to the Assessing Officer having jurisdiction over the concerned association or institution.

(7) Similarly, the Committee can withdraw a notification regarding an eligible project or scheme if it is satisfied that the project or the scheme is not being carried out in accordance with all or any of the conditions subject to which such project or scheme was notified or a report in respect of such eligible project or scheme has not been furnished after the end of each financial year, in the prescribed form within the prescribed time. The National Committee should however, give a reasonable opportunity of showing cause against the proposed withdrawal.

(8) Further, a copy of the notification by which the eligible project or scheme is withdrawn should be forwarded to the Assessing Officer having jurisdiction over the concerned association, institution, public sector company or local authority, as the case may be, carrying on such eligible project or scheme.

(i) Where the approval of the National Committee or the notification in respect of eligible project or scheme is withdrawn in case of a public sector company or local authority, etc; or

(ii) Where a company has claimed deduction in respect of any expenditure incurred directly on the eligible project or scheme and the approval for such project or scheme is withdrawn by the National Committee,

the total amount of payment received by the public sector company or the local authority, etc., as case may be, in respect of which it has furnished to certificate, or the deduction claimed by the company shall be deemed to be the income of such company/authority, etc. for previous year in which the approval or notification is withdrawn. Further, tax will be charged on such income at the maximum marginal rate in force.

(xi) “Investment-linked tax incentives” for specified businesses [Section 35AD]

(i) Although there are a plethora of tax incentives available under the Income-tax Act, 1961 they do not fulfill the intended purpose of creating infrastructure since these incentives are linked to profits and consequently have the effect of diverting profits from the taxable sector to the tax-free sector. Therefore, with the specific objective of creating rural infrastructure and environment friendly alternate means for transportation of bulk goods, investment-linked tax incentives have been introduced for specified businesses, namely–

- setting-up and operating ‘cold chain’ facilities for specified products;
- setting-up and operating warehousing facilities for storing agricultural produce;
- laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network;
- building and operating a hotel of two-star or above category, anywhere in India;
- building and operating a hospital, anywhere in India, with at least 100 beds for patients;
- developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and notified by the CBDT in accordance with the prescribed guidelines.
- developing and building a housing project under a notified scheme for affordable housing framed by the Central Government or State Government;
- production of fertilizer in India;
- setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962;
- bee-keeping and production of honey and beeswax; and
- setting up and operating a warehousing facility for storage of sugar.

(ii) This year the scope of deduction under section 35AD has been extended to the following two businesses which have been included as “specified business” –

- *laying and operating a slurry pipeline for the transportation of iron ore; and*
- *setting up and operating a semiconductor wafer fabrication manufacturing unit, if such unit is notified by the Board in accordance with the prescribed guidelines.*

(iii) 100% of the capital expenditure incurred during the previous year, wholly and exclusively for the above businesses would be allowed as deduction from the business income. However, expenditure incurred on acquisition of any land, goodwill or financial instrument would not be eligible for deduction.

(iv) Further, the expenditure incurred, wholly and exclusively, for the purpose of specified business prior to commencement of operation would be allowed as deduction during the previous year in which the assessee commences operation of his specified business. A condition has been inserted that such amount incurred prior to commencement should be capitalized in the books of account of the assessee on the date of commencement of its operations.

(v) Weighted “investment-linked” tax deduction for certain specified businesses [Section 35AD(1A)]

The following “specified businesses” would be eligible for weighted deduction@150% of the capital expenditure (including capital expenditure incurred before commencement of operations and capitalized in the books of account on the date of commencement of operations) under section 35AD(1A), if they commence operations on or after 1st April, 2012 –

- (1) setting up and operating a cold chain facility;
- (2) setting up and operating a warehousing facility for storage of agricultural produce;
- (3) building and operating, anywhere in India, a hospital with at least 100 beds for patients;
- (4) developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government. Such scheme should be notified by the CBDT in accordance with the prescribed guidelines; and
- (5) production of fertilizer in India.

(vi) For claiming deduction (whether 100% or 150%) under section 35AD, the specified business should fulfill the following conditions -

- (1) it should not be set up by splitting up, or the reconstruction, of a business already in existence;
- (2) it should not be set up by the transfer to the specified business of machinery or plant previously used for any purpose;

In order to satisfy this condition, the total value of the plant or machinery so transferred should not exceed 20% of the value of the total plant or machinery used in the new business.

For the purpose of this condition, machinery or plant would not be regarded as previously used if it had been used outside India by any person other than the assessee provided the following conditions are satisfied:

- (a) such plant or machinery was not used in India at any time prior to the date of its installation by the assessee;
- (b) the plant or machinery was imported into India from a foreign country;

- (c) no deduction in respect of depreciation of such plant or machinery has been allowed to any person at any time prior to the date of installation by the assessee.
 - (3) In respect of the business of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network, such business,—
 - (a) should be owned by a company formed and registered in India under the Companies Act, 1956 or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;
 - (b) should have been approved by the Petroleum and Natural Gas Regulatory Board and notified by the Central Government in the Official Gazette.
 - (c) should have made not less than such proportion of its total pipeline capacity available for use on common carrier basis by any person other than the assessee or an associated person. The common carrier capacity condition prescribed by the regulations of the Petroleum & Natural Gas Regulatory Board is –
 - (1) "one-third" for natural gas pipeline network; and
 - (2) "one-fourth" for petroleum product pipeline network.
 - (d) should fulfill any other prescribed condition.
 - (vii) where a deduction under this section is claimed and allowed in respect of the specified business for any assessment year, no deduction under the provisions of Chapter VI-A under the heading "C.-Deductions in respect of certain incomes" **or section 10AA** is permissible in relation to such specified business for the same or any other assessment year.
- Correspondingly, section 80A has been amended to provide that where a deduction under any provision of this Chapter under the heading "C – Deductions in respect of certain incomes" is claimed and allowed in respect of the profits of such specified business for any assessment year, no deduction under section 35AD is permissible in relation to such specified business for the same or any other assessment year.
- In short, once the assessee has claimed the benefit of deduction under section 35AD for a particular year in respect of a specified business, he cannot claim benefit under Chapter VI-A under the heading "C.-Deductions in respect of certain incomes" **or section 10AA** for the same or any other year and vice versa.
- (viii) The assessee cannot claim deduction in respect of such expenditure incurred for specified business under any other provision of the Income-tax Act, 1961 in the current year or under this section for any other year.
 - (ix) The benefit will be available –
 - (a) in a case where the business relates to laying and operating a cross country natural gas pipeline network for distribution, if such business commences its operations on or after 1st April, 2007;

[Consequently, profit-linked deduction provided under section 80-IA to the business of laying and operating a cross country natural gas distribution network has been discontinued. As a result, any person availing of this incentive can now avail of the benefit under section 35AD].

- (b) in a case where the business relates to setting and operating "cold-chain" facilities for specified products or warehousing facilities for storing agricultural produce, if such business commences its operation on or after 1st April, 2009;
- (c) in the case of the business of affordable housing projects and production of fertilizer in a new plant or in a newly installed capacity in an existing plant, if such business commences operation on or after 1st April, 2011;
- (d) in the case of business of setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962, bee-keeping and production of honey and beeswax and setting up and operating a warehousing facility for storage of sugar, if such business commences operation on or after 1st April, 2012;
- (e) *in a case where the business relates to laying and operating a slurry pipeline for the transportation of iron ore or setting up and operating a semi conductor wafer fabrication manufacturing unit, if such business commences its operations on or after 1st April, 2014;*
- (f) in any other case, if such business commences its operation on or after 1st April, 2010.

Illustration 7

Mr. A commenced operations of the businesses of setting up a warehousing facility for storage of food grains, sugar and edible oil on 1.4.2014. He incurred capital expenditure of ₹ 80 lakh, ₹ 60 lakh and ₹ 50 lakh, respectively, on purchase of land and building during the period January, 2014 to March, 2014 exclusively for the above businesses, and capitalized the same in its books of account as on 1st April, 2014. The cost of land included in the above figures are ₹ 50 lakh, ₹ 40 lakh and ₹ 30 lakh, respectively. Further, during the P.Y.2014-15, it incurred capital expenditure of ₹ 20 lakh, ₹ 15 lakh & ₹ 10 lakh, respectively, for extension/reconstruction of the building purchased and used exclusively for the above businesses. Compute the income under the head "Profits and gains of business or profession" for the A.Y.2015-16 and the loss to be carried forward, assuming that Mr. A has fulfilled all the conditions specified for claim of deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading "C. – Deductions in respect of certain incomes". The profits from the business of setting up a warehousing facility for storage of food grains, sugar and edible oil (before claiming deduction under section 35AD and section 32) for the A.Y. 2015-16 is ₹ 16 lakhs, ₹ 14 lakhs and ₹ 31 lakhs, respectively.

Answer

Computation of profits and gains of business or profession for A.Y.2015-16

Particulars	₹ (in lakhs)
Profit from business of setting up of warehouse for storage of edible oil (before providing for depreciation under section 32)	31
Less: Depreciation under section 32	
10% of ₹ 30 lakh, being (₹ 50 lakh – ₹ 30 lakh + ₹ 10 lakh)	<u>3</u>
Income chargeable under "Profits and gains from business or profession"	<u>28</u>

Computation of income/loss from specified business under section 35AD

	Particulars	Food Grains	Sugar	Total
		₹ (in lakhs)		
(A)	Profits from the specified business of setting up a warehousing facility (before providing deduction under section 35AD)	16	14	30
	Less: Deduction under section 35AD			
(B)	Capital expenditure incurred prior to 1.4.2014 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2014 (excluding the expenditure incurred on acquisition of land) = ₹ 30 lakh (₹ 80 lakh – ₹ 50 lakh) and ₹ 20 lakh (₹ 60 lakh – ₹ 40 lakh)	30	20	50
(C)	Capital expenditure incurred during the P.Y.2014-15	20	15	35
(D)	Total capital expenditure (B + C)	50	35	85
(E)	Deduction under section 35AD			
	150% of capital expenditure (food grains)	75		
	100% of capital expenditure (sugar)		35	
	Total deduction u/s 35AD for A.Y.2015-16	75	35	110
(F)	Loss from the specified business of setting up and operating a warehousing facility (after providing for deduction under section 35AD) to be carried forward as per section 73A (A-E)	(59)	(21)	(80)

Notes:

- (1) Weighted deduction@150% of the capital expenditure is available under section 35AD for A.Y.2015-16 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2012. Food grains constitute agricultural produce and therefore, the capital expenditure incurred for setting up a warehousing facility for storage of food grains is eligible for weighted deduction@150% under section 35AD.
- (2) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2015-16 in respect of specified business of setting up and operating a warehousing facility for storage of sugar, where operations are commenced on or after 01.04.2012.
- (3) However, since setting up and operating a warehousing facility for storage of edible oils is not a specified business, Mr. A is not eligible for deduction under section 35AD in respect of capital expenditure incurred in respect of such business.
- (4) Mr. A can, however, claim depreciation@10% under section 32 in respect of the capital expenditure incurred on buildings. It is presumed that the buildings were put to use for more than 180 days during the P.Y.2014-15.
- (5) Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of ₹ 80 lakh from the specified businesses of setting up and operating a warehousing facility for storage of food grains and sugar cannot be set-off against the profits of ₹ 28 lakh from the business of setting and operating a warehousing facility for storage of edible oils, since the same is not a specified business. Such loss can, however, be carried forward indefinitely for set-off against profits of the same or any other specified business.
- (x) "Cold chain facility" means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce.

An "associated person" in relation to the assessee means a person—

- (1) who participates directly or indirectly or through one or more intermediaries in the management or control or capital of the assessee;
- (2) who holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the capital of the assessee;
- (3) who appoints more than half of the Board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of the assessee; or
- (4) who guarantees not less than 10% of the total borrowings of the assessee.

(xi) In respect of the business of hotels and hospitals, the word "new" has been removed from the definition of "specified business". Therefore, "specified business" means the business of building and operating, anywhere in India, -

- (1) a hotel of two-star or above category as classified by the Central Government;
- (2) a hospital with at least one hundred beds for patients.

Consequently, the loss of an assessee claiming deduction under section 35AD in respect of a specified business can be set-off against the profit of another specified business under section 73A, irrespective of whether the latter is eligible for deduction under section 35AD. As assessee can, therefore, set-off the losses of a hospital or hotel which begins to operate after 1st April, 2010 and which is eligible for deduction under section 35AD, against the profits of the existing business of operating a hospital (with atleast 100 beds for patients) or a hotel (of two-star or above category), even if the latter is not eligible for deduction under section 35AD.

Illustration 8

XYZ Ltd. commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on 1.4.2014. The company incurred capital expenditure of ₹ 50 lakh during the period January, 2014 to March, 2014 exclusively for the above business, and capitalized the same in its books of account as on 1st April, 2014. Further, during the P.Y.2014-15, it incurred capital expenditure of ₹ 2 crore (out of which ₹ 1.50 crore was for acquisition of land) exclusively for the above business. Compute the income under the head "Profits and gains of business or profession" for the A.Y.2015-16, assuming that XYZ Ltd. has fulfilled all the conditions specified for claim of deduction under section 35AD and has not claimed any deduction under Chapter VI-A under the heading "C. – Deductions in respect of certain incomes". The profits from the business of running this hotel (before claiming deduction under section 35AD) for the A.Y.2015-16 is ₹ 25 lakhs. Assume that the company also has another existing business of running a four-star hotel in Coimbatore, which commenced operations 5 years back, the profits from which are ₹ 120 lakhs for the A.Y.2015-16.

Solution

Particulars	₹
Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)	25 lakh
Less: Deduction under section 35AD	
Capital expenditure incurred during the P.Y.2014-15 (excluding the expenditure incurred on acquisition of land) = ₹ 200 lakh – ₹ 150 lakh	50 lakh
Capital expenditure incurred prior to 1.4.2014 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2014	<u>50 lakh</u>
Total deduction under section 35AD for A.Y.2015-16	<u>100 lakh</u>

Loss from the specified business of new hotel in Madurai	(75 lakh)
Profit from the existing business of running a hotel in Coimbatore	<u>120 lakh</u>
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A	<u>45 lakh</u>

(xii) Where the assessee builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation of the said hotel to another person, the assessee shall be deemed to be carrying on the specified business of building and operating a hotel. Therefore, he would be eligible to claim investment-linked tax deduction under section 35AD.

Therefore, in effect, the assessee shall be deemed to be carrying on the specified business of building and operating hotel if –

- (1) The assessee builds a hotel of two-star or above category;
- (2) Thereafter, he transfers the operation of the hotel to another person;
- (3) He, however, should continue to own the hotel.

(xiii) Where any goods or services held for the purposes of the specified business are transferred to any other business carried on by the assessee, or vice versa, and if the consideration for such transfer does not correspond with the market value of the goods or services then the profits and gains of the specified business shall be computed as if the transfer was made at market value.

For the above purpose, "market value" means the price such goods or services would ordinarily fetch in the open market, subject to statutory or regulatory restrictions, if any.

(xiv) The deduction shall be allowed to the assessee only if the accounts of the assessee for the relevant previous year have been audited by a chartered accountant and the assessee furnishes the audit report in the prescribed form, duly signed and verified by such accountant along with his return of income.

(xv) Where it appears to the Assessing Officer that the assessee derives more than ordinary profits from the specified business due to close connection between the assessee and any other person, or due to any other reason, the Assessing Officer may consider such profits as may be reasonably deemed to have been derived from the specified business for the purpose of computing deduction under this section.

(xvi) Section 35AD(7A) provides that any asset in respect of which a deduction is claimed and allowed under section 35AD shall be used only for the specified business for a period of eight years beginning with the previous year in which such asset is acquired or constructed.

(xvii) If any asset on which a deduction under section 35AD has been claimed and allowed, is demolished, destroyed, discarded or transferred, the sum received or receivable for the same is chargeable to tax under clause (vii) of section 28. This does not take into account a case where asset on which deduction under section 35AD has

been claimed is used for any purpose other than the specified business by way of a mode other than that specified above.

(xviii) Accordingly, sub-section (7B) has been inserted to provide that if such asset is used for any purpose other than the specified business, the total amount of deduction so claimed and allowed in any previous year in respect of such asset, as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction had been allowed under section 35AD, shall be deemed to be income of the assessee chargeable under the head "Profits and gains of business or profession" of the previous year in which the asset is so used.

(xix) However, the deeming provision under sub-section (7B) shall not be applicable to a company which has become a sick industrial company under section 17(1) of the Sick Industrial Companies (Special Provisions) Act, 1985, during the intervening period of eight years specified in sub-section (7A).

Illustration 9

ABC Ltd. is a company having two units – Unit A carries on specified business of setting up and operating a warehousing facility for storage of sugar; Unit B carries on non-specified business of operating a warehousing facility for storage of edible oil. Unit A commenced operations on 1.4.2013 and it claimed deduction of ₹ 100 lacs incurred on purchase of two buildings for ₹ 50 lacs each (for operating a warehousing facility for storage of sugar) under section 35AD for A.Y.2014-15. However, in February, 2015, Unit A transferred one of its buildings to Unit B.

Examine the tax implications of such transfer in the hands of ABC Ltd.

Solution

Since the capital asset, in respect of which deduction of ₹ 50 lacs was claimed under section 35AD, has been transferred by Unit A carrying on specified business to Unit B carrying on non-specified business in the P.Y.2014-15, the deeming provision under section 35AD(7B) is attracted during the A.Y.2015-16.

Particulars	₹
Deduction allowed under section 35AD for A.Y.2014-15	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2014-15 [10% of ₹ 50 lacs]	5,00,000
Deemed income under section 35AD(7B)	45,00,000

(xii) Contributions for Rural Development [Section 35CCA]: This section allows a deduction of the following expenditure incurred by the assessee during the previous year:

(1) Payment to an association or institution, having the objective of undertaking programmes of rural development. Such payment must be used for carrying out any programme of rural development approved by the prescribed authority.

Conditions for allowance:

- (a) The assessee must furnish a certificate from such association (which should be authorised by the prescribed authority to issue such a certificate) that the programme of rural development had been approved by the prescribed authority before 1-3-1983 and
 - (b) Where such payment is made after 28-2-1983, the programme should involve work by way of (i) construction of any building, or other structure (to be used for dispensary, school, training or welfare centre, workshop, etc.) or (ii) the laying of any road or (iii) the construction or boring of a well or tube well or (iv) the installation of any plant or machinery and such work must have commenced before 1-3-1983.
- (2) Payment to an association or institution having as its object the training of persons for implementing rural development programme.

Conditions:

- (a) Assessee must furnish a certificate from such association (which should be authorised by the prescribed authority to issue such a certificate) that it has been approved by the prescribed authority before 1-3-1983.
- (b) Such training of persons must have started before 1-3-1983.

The deduction to which an assessee is entitled on account of payment of any sum by him to an association or institution for carrying out the programme of rural development shall not be denied to the assessee merely on the ground that after payment of such sum by him, the approval granted to such programme or, as the case may be, to the association or institution has been withdrawn.

- (3) Payment to a rural development fund set up and notified by the Central Government.

The expression 'programme of rural development' for this purpose have the same meaning as has been assigned to it under Explanation to section 35CC(i).

- (4) Payments made to "National Urban Poverty Eradication Fund" (NUPEF) set up and notified by the Central Government.

It has been specifically provided that in every case where any deduction in respect of contribution for rural development is claimed by the assessee and allowed to him for any assessment year in respect of any expenditure incurred by way of payment of contribution to the approved association or institution, no deduction in respect of the same expenditure can again be claimed by the assessee under any other relevant provision.

(xiii) Weighted deduction in respect of expenditure incurred on notified agricultural extension project [Section 35CCC]

- (1) In order to incentivize the business entities to provide better and effective agriculture extensive services, section 35CCC provides a weighted deduction of a sum equal to 150% of expenditure incurred by an assessee on agricultural extension project in accordance with the prescribed guidelines.

- (2) In case deduction in respect of such expenditure is allowed under this section then, no deduction in respect of such expenditure shall be allowed under any other provisions of the Act in the same or any other assessment year.
- (3) The agricultural extension project eligible for this weighted deduction shall be notified by the CBDT.

Accordingly, the CBDT in exercise of the powers conferred by section 295 read with section 35CCC(1), vide Notification No. 38/2013 dated 30.05.2013, prescribed rule 6AAD and 6AAE that contains the guidelines and conditions, for approval of the agricultural extension project. Rule 6AAD has been substituted and Rule 6AAE has been amended by Notification No. 18/204 dated 21.3.2014].

(a) Conditions to be fulfilled for approval of agricultural extension project under section 35CCC [Rule 6AAD]:

The agricultural extension project shall be considered for notification if it fulfils all of the following conditions, namely:—

- (i) *the project shall be undertaken by an assessee for training, education and guidance of farmers;*
- (ii) *the project shall have prior approval of the Ministry of Agriculture, Government of India; and*
- (iii) *an expenditure (not being expenditure in the nature of cost of any land or building) exceeding the amount of twenty-five lakh rupees is expected to be incurred for the project.*

An assessee shall make an application in the prescribed form to the Member (IT), CBDT for notification of such project under section 35CCC.

(b) Conditions to be fulfilled for claiming weighted deduction [Rule 6AAE]:

- (i) *The assessee undertaking agricultural extension project shall maintain separate books of account of such agricultural extension project and get such books of account audited by an Accountant.*
- (ii) *The audit report shall include the comments of the auditor on the true and fair view of the books of account maintained for agricultural extension project, the genuineness of the activities of the agricultural extension project and fulfillment of the conditions specified in the relevant provisions of the Act or the rules.*
- (iii) *The assessee shall not accept an amount exceeding the amount as approved in the notification from the beneficiary under the eligible agricultural extension project for training, education, guidance or any material distributed for the purposes of such training, education or guidance.*
- (iv) *The assessee shall not get any direct or indirect benefit from the notified agricultural extension project except the deduction of the eligible expenditure*

in accordance with the provisions of section 35CCC of the Act and prescribed rules.

- (v) *All expenses (not being expenditure in the nature of cost of any land or building), as reduced by the amount received from beneficiary, if any, incurred wholly and exclusively for undertaking an eligible agricultural extension project shall be eligible for deduction under section 35CCC.*

However, expenditure incurred on the agricultural extension project which is reimbursed or reimbursable to the assessee by any person, whether directly or indirectly, shall not be eligible for deduction under section 35CCC.

- (vi) *The assessee shall, on or before the due date of furnishing the return of income under section 139(1), furnish the following to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, namely:—*

(a)	<i>the audited statement of accounts of the agricultural extension projects for the previous year along with the audit report and amount of deduction claimed under section 35CCC(1).</i>
(b)	<i>a note on the agricultural extension project undertaken by it during the previous year and the programme of agricultural extension project to be undertaken during the current year and the financial allocation for such programme; and</i>
(c)	<i>a certificate from the Ministry of Agriculture, Government of India, regarding the genuineness of the agricultural extension project undertaken by the assessee during the previous year.</i>

(xiv) Weighted deduction in respect of expenditure incurred by companies on notified skill development project [Section 35CCD]

- (1) The National Manufacturing Policy (NMP) has been notified by the Department of Industrial Policy & Promotion (DIPP) vide Press Note dated 4th November, 2011. As per the notified NMP, the government will provide weighted standard deduction of 150% of the expenditure (other than land or building) incurred on Public Private Partnership (PPP) project for skill development in the ITIs in manufacturing sector. This is to encourage private sector to set up their own institution in coordination with National Skill Development Corporation.
- (2) In order to encourage companies to invest on skill development projects in the manufacturing sector, section 35CCD provides for a weighted deduction of a sum equal to 150% of the expenditure (not being expenditure in the nature of cost of any land or building) on skill development project incurred by the company in accordance with the prescribed guidelines.
- (3) In case deduction in respect of such expenditure is allowed under this section then, no deduction of such expenditure shall be allowed under any other provisions of the Act in the same or any other assessment year.

- (4) The skill development project eligible for this weighted deduction shall be notified by the CBDT.

Accordingly, the CBDT has, in exercise of the powers conferred by section 295 read with section 35CCD(1), laid down the guidelines and conditions for approval of a skill development project under section 35CCD.

S. No.	Particulars																						
(1)	<p><u>Guidelines for approval of Skill Development Project under section 35CCD:</u></p> <p>A skill development project shall be considered for notification if it is undertaken by an eligible company and the project is undertaken in separate facilities in a training institute [Rule 6AAF(1)]</p>																						
(i)	<p>"Eligible company" means a company, which is -</p> <ul style="list-style-type: none"> engaged in the business of manufacture or production of any article or thing specified in the Eleventh Schedule; not being beer, wine and other alcoholic spirits and tobacco & tobacco preparations such as cigars and cheroots, cigarettes, biris, smoking mixtures for pipes and cigarettes, chewing tobacco and snuff or engaged in providing the following services <table> <tr> <th>S. No.</th><th>Particulars</th></tr> <tr> <td>1.</td><td>Accounting services</td></tr> <tr> <td>2.</td><td>Architect services</td></tr> <tr> <td>3.</td><td>Automobile repair or maintenance</td></tr> <tr> <td>4.</td><td>Banking, insurance and financial services including ATM installation, maintenance and operations or banking correspondents or insurance agents</td></tr> <tr> <td>5.</td><td>Beauty and cosmetology, including hair styling or manicurists or pedicurists</td></tr> <tr> <td>6.</td><td>Cable operators or Direct To Home (DTH) services</td></tr> <tr> <td>7.</td><td>Cargo Handling and stevedoring services</td></tr> <tr> <td>8.</td><td>Construction including painting or woodwork or plumbing or flooring or electrical wiring or installation or maintenance of lifts</td></tr> <tr> <td>9.</td><td>Courier services</td></tr> <tr> <td>10.</td><td>Design services including fashion or gems and jewellery or apparel or industrial designing</td></tr> </table>	S. No.	Particulars	1.	Accounting services	2.	Architect services	3.	Automobile repair or maintenance	4.	Banking, insurance and financial services including ATM installation, maintenance and operations or banking correspondents or insurance agents	5.	Beauty and cosmetology, including hair styling or manicurists or pedicurists	6.	Cable operators or Direct To Home (DTH) services	7.	Cargo Handling and stevedoring services	8.	Construction including painting or woodwork or plumbing or flooring or electrical wiring or installation or maintenance of lifts	9.	Courier services	10.	Design services including fashion or gems and jewellery or apparel or industrial designing
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			<ol style="list-style-type: none"> 11. <i>Event management</i> 12. <i>Facilities management, housekeeping, cleaning services</i> 13. <i>Fire and safety services</i> 14. <i>Food processing or preservation services, including post harvesting and post farm gate skills</i> 15. <i>Health and Wellness services including spa or nutritionists or weight management or health instructors or yoga or gym trainers</i> 16. <i>Home decor services, landscaping</i> 17. <i>Hospital and Healthcare services, such as Lab technicians, nursing and other paramedical staff</i> 18. <i>Hospitality, including culinary skills or catering services</i> 19. <i>Logistics and Transportation by any mode, including by air, sea, road, rail or pipelines, and related services such as driving or operation of heavy machinery equipment, forwarding agents, packers and movers</i> 20. <i>Market research services</i> 21. <i>Media or film or advertising</i> 22. <i>Mining and extraction of mineral resources, including hydrocarbons</i> 23. <i>Packaging and Warehousing, including both ambient temperature storage and cold storage, operation of Internal Container Depots and Container Freight Stations</i> 24. <i>Port and maritime services such as dredging, piloting, tug boat operations, shipbuilding, ship scrapping, bunkering</i> 25. <i>Power Sector Services, including those required for erection or installation or maintenance of equipment or towers, etc. in generation, transmission or distribution sector projects</i> 26. <i>Private Security, including guards, supervisors, installation and maintenance of security equipment etc.</i> 27. <i>Refrigeration and air-conditioning</i> 28. <i>Repair and maintenance services, including Installation and servicing of household goods or white goods</i> 29. <i>Retail marketing, including shop floor assistants or merchandisers</i> 30. <i>Telecom services, including erection and maintenance of towers</i> 31. <i>Travel and tourism, including guides or ticketing or sales or cab drives</i>
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	<p>(ii) <i>“Training Institute” means a training institute set up by the Central or State Government or a local authority or a training institute affiliated to National Council for Vocational Training or State Council for Vocational Training.</i></p> <p><i>A skill development project in respect of existing employees of the company shall not be eligible for notification under section 35CCD(1), where the training of such employees commences after six months of their recruitment [Rule 6AAG(3)].</i></p>
(2)	<p><u>Application for approval of project [Rule 6AAF(2)]:</u></p> <p><i>Such company, before undertaking any skill development project, shall :</i></p> <ul style="list-style-type: none"> - <i>make an application for notification of such project under section 35CCD(1), in duplicate, in Form No. 3CQ, to the National Skill Development Agency(NSDA); and</i> - <i>also send a copy of the application in Form No. 3CQ to the Commissioner of Income tax or the Director of the Income tax as the case may be, having jurisdiction over the case, accompanied by the acknowledgement receipt as evidence of having furnished the application form in duplicate to the NSDA.</i>
(3)	<p><u>Conditions laid down under Rule 6AAG:</u></p> <p>(i) <i>The Company which undertakes a skill development project shall maintain separate books of account of the skill development project and get such books of account audited by an Accountant.</i></p> <p>(ii) <i>All expenses (not being expenditure in the nature of cost of any land or building), incurred wholly and exclusively for undertaking a notified skill development project shall be eligible for deduction under section 35CCD.</i></p> <p><i>However, the expenditure incurred on the skill development project which is reimbursed or reimbursable to the company by any person, whether directly or indirectly, shall not be eligible for deduction under section 35CCD.</i></p> <p>(iii) <i>The company shall, on or before the due date of furnishing the return of income under section 139(1), furnish the audited statement of accounts of the skill development project for the previous year along with the audit report and amount of deduction claimed under section 35CCD(1) to the Commissioner of Income-tax or the Director of Income-tax, as the case may be.</i></p>

(xv) **Amortisation of Preliminary Expenses [Section 35D]** : (1) Section 35D provides for the amortisation of preliminary expenses incurred by Indian companies and other resident non-corporate taxpayers for the establishment of business concerns or the expansion of the business of existing concerns.

(2) This section applies (a) only to Indian companies and resident non-corporate assesseees; (b) in the case of new companies to expenses incurred before the commencement of the

business; (c) in the case of extension of an existing undertaking to expenses incurred till the extension is completed, i.e., in the case of the setting up of a new unit - to expenses incurred till the new unit commences production or operation.

(3) Such preliminary expenditure incurred shall be amortised over a period of 5 years. In other words, 1/5th of such expenditure is allowable as a deduction for each of the five successive previous years beginning with the previous year in which the business commences or, the previous year in which the extension of the undertaking is completed or the new unit commences production or operation, as the case may be.

(4) Eligible expenses - The following expenditure are eligible for amortisation:

(i) Expenditure in connection with - (a) the preparation of feasibility report (b) the preparation of project report; (c) conducting market survey or any other survey necessary for the business of the assessee; (d) engineering services relating to the assessee's business; (e) legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up to conduct the business of assessee.

(ii) Where the assessee is a company, in addition to the above, expenditure incurred - (f) by way of legal charges for drafting the Memorandum and Articles of Association of the company; (g) on printing the Memorandum and Articles of Association; (h) by way of fees for registering the company under the Companies Act; 1956, (i) in connection with the issue, for public subscription, of the shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, printing and advertisement of the prospectus; and

(iii) Such other items of expenditure (not being expenditure qualifying for any allowance or deduction under any other provision of the Act) as may be prescribed by the Board for the purpose of amortisation. However, the Board, so far, has not prescribed any specific item of expense as qualifying for amortisation under this clause.

In the case of expenditure specified in items (a) to (e) above, the work in connection with the preparation of the feasibility report or the project report or the conducting of market survey or any other survey or the engineering services referred to must be carried out by the assessee himself or by a concern which is for the time being approved in this behalf by the Board.

(5) Overall Limits - The maximum aggregate amount of the qualifying expenses that can be amortised has been fixed at 5% of the cost of the project or in the case of an Indian company, or, at the option of the company, 5% of the capital employed in the business of the company, whichever is higher. The excess, if any, of the qualifying expenses shall be ignored.

The assessee is entitled to a deduction of an amount equal to one-fifth of the qualifying amount of the expenditure for each of the five successive accounting years beginning with the year in which the business commences, or as the case may be, the previous year in which the business commences or as the case may be, the previous year in which extension of the undertaking is completed or the new unit commences production or operation.

(6) For purpose of amortisation, the expression, '**cost of the project**' means -

(i) In the case of expenses incurred before the commencement of business the actual cost

of the fixed assets, being land, buildings, leaseholds, plant, machinery, furniture, fittings, railway sidings (including expenditure on the development of land, buildings) which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences;

(ii) in case of extension of the business or setting up of a new unit, the cost of the fixed assets being land, buildings, leaseholds, plant, machinery, furniture, fittings, and railway sidings (including expenditure on the development of land and buildings) which are shown in the books of the assessee as on the last day of the previous year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, insofar as such assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit.

(7) The expression “**capital employed in the business of the company**” means -

(i) in the case of new company, the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the previous year in which the business of the company commences;

(ii) in the case of extension of the business or the setting up of a new unit, the aggregate of the issued share capital, debentures, and long-term borrowings as on the last day of the accounting year in which the extension of the undertaking is completed or, as the case may be, the unit commences production or operation insofar as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or the setting up of the new undertaking or the setting up of the new unit of the company.

(8) The expression “long-term borrowing,” mentioned above, means any moneys borrowed in India by the company from the Government or the Industrial Finance Corporation of India or the Industrial Credit and Investment Corporation of India or any other financial institution eligible for deduction under section 36(1)(iii) or any banking institution, or any moneys borrowed or debt incurred by it in a foreign country in respect of the purchase outside India of plant and machinery where the terms under which such moneys are borrowed or the debt is incurred provide for the repayment thereof during a period of not less than seven years.

(9) In cases where the assessee is a person other than a company or a co-operative society, the deduction would be allowable only if the accounts of the assessee for the year or years in which the expenditure is incurred have been audited by a Chartered Accountant and the assessee furnishes, along with his return of income for the first year in respect of which the deduction is claimed, the report of such audit in the prescribed form duly signed and verified by the auditor and setting forth such other particulars as may be prescribed.

(10) Special provisions for amalgamation and demerger- Where the undertaking of an Indian company is transferred, before the expiry of the period of ten years, to another Indian company under a scheme of amalgamation as defined in section 2(IA) the aforesaid provisions will apply to the amalgamated company as if the amalgamation had not taken place. But no

deduction will be admissible in the case of the amalgamating company for the previous year in which the amalgamation takes place.

Sub-section (5A) provides similar provisions for the scheme of demerger where the resulting company will be able to claim amortisation of preliminary expenses as if demerger had not taken place, and no deduction shall be allowed to the demerged company in the year of demerger.

It has been clarified that in case where a deduction under this section is claimed and allowed for any assessment year in respect of any item of expenditure, the expenditure in respect of which deduction is so allowed shall not qualify for deduction under any other provision of the Act for the same or any other assessment year.

(xvi) Amortisation of Expenses for Amalgamation/Demerger [Section 35DD]: (1) Where an assessee, being an Indian company, incurs expenditure on or after 1st April, 1999, wholly and exclusively for the purpose of amalgamation or demerger, the assessee shall be allowed a deduction equal to one-fifth of such expenditure for five successive previous years beginning with the previous year in which amalgamation or demerger takes place.

(2) No deduction shall be allowed in respect of the above expenditure under any other provisions of the Act.

(xvii) Amortisation of expenditure incurred under voluntary retirement scheme [Section 35DDA] : (1) This section applies to an assessee who has incurred expenditure in any previous year in the form of payment to any employee in connection with his voluntary retirement, in accordance with any scheme or schemes of voluntary retirement.

(2) The amount of deduction allowable is one-fifth of the amount paid for that previous year, and the balance in four equal installments in the four immediately succeeding previous years.

(3) In case of amalgamation, demerger, reorganisation or succession of business during the intervening period of the said 5 years, the benefit of deduction will be available to the "new company" for the balance period including the year in which such amalgamation/demerger/reorganisation or succession takes place.

(4) This will be applicable in the following situations:

- (i) where an Indian company is transferred to another Indian company in a scheme of amalgamation;
- (ii) where the undertaking of an Indian company is transferred to another company in a scheme of demerger;
- (iii) where due to a re-organisation of business, a firm is succeeded by a company fulfilling the conditions in section 47(xiii) or a proprietary concern is succeeded by a company fulfilling the conditions in section 47(xiv);
- (iv) where a company has converted into a LLP fulfilling the conditions laid down in section 47(xiiib).

(5) In the above cases, the deduction shall be available to the successor company as such deduction would have applied to the original entity if such transfer had not taken place at all.

(6) It is further provided that no deduction shall be available to the original entity being the amalgamating company, or the demerged company or the firm or proprietary concern (as the case may be) for the previous year in which the amalgamation, demerger or succession takes place.

(7) No deduction shall be allowed in respect of the above expenditure under any other provision of the Act.

(xviii) Amortisation of expenses for prospecting and development of certain minerals

[Section 35E] – (1) This provision applies only to expenditure incurred by an Indian company or any other person who is resident in India. Thus, foreign companies or foreign concerns and non-resident assesseees are not entitled for the benefits of deduction under section 35E. In order to qualify for amortisation, the assessee should be engaged in any operations relating to prospecting for or the extraction or production of any mineral.

(2) Eligible expenses - The nature and kind of expenditure qualifying for amortisation are -

(i) It must have been incurred during the year of commercial production or any one or more of the four years immediately preceding that year, (ii) It must be an expenditure incurred wholly and exclusively on any operations relating to the prospecting for or extraction of certain minerals listed in the Seventh Schedule of the Income-tax Act, 1961.

(3) Expenditure not allowed for deduction - However, any portion of the expenditure which is met directly or indirectly by any other persons or authority and the sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or rights brought into existence as a result of the expenditure should be excluded from the amount of expenditure qualifying for amortisation. Further, specific provision has been made to the effect that the following items of expenses do not qualify for amortisation at all viz.:

- (i) Expenditure incurred on the acquisition of the site of the source of any minerals or group of associated minerals stated above or of any right in or over such site;
- (ii) Expenditure on the acquisition of the deposits of minerals or group of associated minerals referred to above or to any rights in or over such deposits; or
- (iii) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is permissible under section 32.

(4) Amount of deduction - The assessee will be allowed for each of ten relevant previous years, a deduction of an amount equal to one-tenth of the aggregate amount of the qualifying expenditure. Thus, the deduction to be allowed for any relevant previous year is (i) one-tenth of the expenditure or (ii) such amount as will reduce to nil the income of the previous year arising from the commercial exploration of any minerals or other natural deposit of the mineral or minerals in a group of associated minerals in respect of which the expenditure was incurred, whichever figure is less. The amount of the deduction admissible in respect of any relevant previous year to the extent to which it remains unallowed, shall be carried forward and added to the installment relating to the previous year next following and shall be deemed to be a part of the installment and so on, for ten previous years beginning from the year of commercial production.

(5) For purposes of this amortisation, the expression "operation relating to prospecting" means any operation undertaken for the purpose of exploiting, locating or proving deposits of any minerals and includes any such operation which proves to be infructuous or abortive. The expression 'year of commercial production' means the previous year in which as a result of any operation relating to prospecting or commercial production of any material or one or more of the minerals in a group of associated minerals specified in Part A or Part B, respectively, of the Seventh Schedule to Act actually commences. The relevant previous year in which the deduction would be allowed to the assessee are those ten previous years beginning with the year of commercial production.

(6) In the case of amalgamation, such deduction would continue to be admissible to the amalgamated company as if the amalgamation had not taken place.

Sub-section (7A) provides for similar provisions in cases of demerger where such deduction can be availed of by the resulting company as if the demerger had not taken place.

Further, no deduction will be admissible to the amalgamating/demerged company in the year of amalgamation/demergers.

(7) Where a deduction is claimed and allowed on account of amortisation of the expenses under section 35E in any year in respect of any expenditure, the expenditure in respect of which deduction is so allowed shall not again qualify for deduction from the profits and gains under any other provisions of the Act for the same or any other assessment year. The provisions with regard to audit of accounts relating to the qualifying expenditure are similar to those applicable for amortisation of preliminary expenses discussed earlier.

(xix) Other Deductions [Section 36] - This section authorises deduction of certain specific expenses. The items of expenditure and the conditions under which such expenditures are deductible are:

(1) Insurance premia paid [Section 36(1)(i)] - If insurance policy has been taken out against risk, damage or destruction of the stock or stores of the business or profession, the premia paid is deductible. But the premium in respect of any insurance undertaken for any other purpose is not allowable under the clause.

(2) Insurance premia paid by a Federal Milk Co-operative Society [Section 36(1)(ia)] - Deduction is allowed in respect of the amount of premium paid by a Federal Milk Co-operative Society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society being a primary society engaged in supply of milk raised by its members to such Federal Milk Co-operative Society. The deduction is admissible without any monetary or other limits.

(3) Premia paid by employer for health insurance of employees [Section 36(1)(ib)] - This clause seeks to allow a deduction to an employer in respect of premia paid by him by any mode of payment other than cash to effect or to keep in force an insurance on the health of his employees in accordance with a scheme framed by (i) the General Insurance Corporation of India and approved by the Central Government; or (ii) any other insurer and approved by the IRDA.

(4) Bonus and Commission [Section 36(1)(ii)] - These are deductible in full provided the sum paid to the employees as bonus or commission shall not be payable to them as profits or dividends if it had not been paid as bonus or commission. It is a provision intended to safeguard against a private company or an association escaping tax by distributing a part of its profits by way of bonus amongst the members, or employees of their own concern instead of distributing the money as dividends or profits.

(5) Interest on borrowed capital [Section 36(1)(iii)] - In the case of genuine business borrowings, the department cannot disallow any part of the interest on the ground that the rate of interest is unreasonably high except in cases falling under section 40A.

Under section 36(1), deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession".

Capital may be borrowed for several purposes like for acquiring a capital asset, or to pay off a trading debt or loss etc. The scope of the expression 'for the purposes of business' is very wide. Capital may be borrowed in the course of the existing business as well as for acquiring assets for extension of existing business. *Explanation 8* to section 43(1) clarifies that interest relating to a period after the asset is first put to use cannot be capitalised. Interest in respect of capital borrowed for any period from the date of borrowing to the date on which the asset was first put to use should normally be capitalised. However, there was scope for the assessee to claim it as a revenue expenditure.

It has now been provided that no such deduction shall be allowed in respect of any amount of interest paid, in respect of capital borrowed for acquisition of new asset for extension of existing business or profession (whether capitalised in the books of account or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use. It is significant to note here that even after the amendment the scope for claiming such interest as revenue expenditure in respect of existing business still exists.

(6) Discount on Zero Coupon Bonds (ZCBs) [Section 36(1)(iiia)] - Section 36(1)(iiia) provides deduction for the discount on ZCB on pro rata basis having regard to the period of life of the bond to be calculated in the manner prescribed. The Explanation seeks to provide the meaning of the expression 'discount' as a difference of the amount received or receivable by an infrastructure capital company/infrastructure capital fund/public sector company/scheduled bank on issue of the bond and the amount payable by such company or fund or bank on maturity or redemption of the bond. The expression 'period of life of the bond' has been defined to mean the period commencing from the date of issue of the bond and ending on the date of the maturity or redemption.

For definitions of "infrastructure capital company" and "infrastructure capital fund", refer sections 2(26A) and 2(26B) in Chapter 1 of this study material – Basic Concepts.

(7) Contributions to provident and other funds [Section 36(1)(iv) and (v)] - Contribution to the employees' provident and other funds are allowable subject to the following conditions:

- (a) The fund should be settled upon a trust.
- (b) In case of Provident or a superannuation or a Gratuity Fund, it should be one recognised or approved under the Fourth Schedule to the Income-tax Act, 1961.
- (c) The amount contributed should be periodic payment and not an adhoc payment to start the fund.
- (d) The fund should be for exclusive benefit of the employees.

The nature of the benefit available to the employees from the fund is not material; it may be pension, gratuity or provident fund.

(8) Employer's contribution to the account of the employee under a Pension Scheme referred to in section 80CCD [Section 36(1)(iva)]

- (i) Section 36(1)(iva) to provide that the employer's contribution to the account of an employee under a Pension Scheme as referred to in section 80CCD would be allowed as deduction while computing business income.
- (ii) However, deduction would be restricted to 10% of salary of the employee in the previous year.
- (iii) Salary, for this purpose, includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.
- (iv) Correspondingly, section 40A(9), which provides for disallowance of any sum paid by an employer towards contribution to any fund or trust has been amended to exclude from the scope of its disallowance, contribution by an employer to the pension scheme referred to in section 80CCD, to the extent to which deduction is allowable under section 36(1)(iva).

Illustration 10

X Ltd. contributes 20% of basic salary to the account of each employee under a pension scheme referred to in section 80CCD. Dearness Allowance is 40% of basic salary and it forms part of pay of the employees. Compute the amount of deduction allowable under section 36(1)(iva), if the basic salary of the employees aggregate to ₹ 10 lakh. Would disallowance under section 40A(9) be attracted, and if so, to what extent?

Solution

Computation of deduction under section 36(1)(iva) and disallowance under section 40A(9)

Particulars	₹
Basic Salary	10,00,000
Dearness Allowance@40% of basic salary [DA forms part of pay]	<u>4,00,000</u>
Salary for the purpose of section 36(1)(iva) (Basic Salary + DA)	<u>14,00,000</u>
Actual contribution (20% of basic salary i.e., 20% of ₹ 10 lakh)	2,00,000
Less: Permissible deduction under section 36(1)(iva) (10% of basic salary plus dearness pay = 10% of ₹ 14,00,000 = ₹ 1,40,000)	<u>1,40,000</u>
Excess contribution disallowed under section 40A(9)	<u>60,000</u>

(9) Amount received by assessee as contribution from his employees towards their welfare fund to be allowed only if such amount is credited on or before due date - Clause (va) of section 36(1) and clause (ia) of section 57 provide that deduction in respect of any sum received by the taxpayer as contribution from his employees towards any welfare fund of such employees will be allowed only if such sum is credited by the taxpayer to the employee's account in the relevant fund on or before the due date. For the purposes of this section, "due date" will mean the date by which the assessee is required as an employer to credit such contribution to the employee's account in the relevant fund under the provisions of any law on term of contract of service or otherwise.

As per the Employees Provident Funds Scheme, 1952, the amounts under consideration in respect of wages of the employees for any particular month shall be paid within 15 days of the close of every month. A further grace period of 5 days is allowed.

(10) Allowance for animals [Section 36(1)(vi)] - This clause grants an allowance in respect of animals which have died or become permanently useless. The amount of the allowance is the difference between the actual cost of the animals and the price realised on the sale of the animals themselves or their carcasses. The allowance under the clause would thus recoup to the assessee the entire capital expenditure in respect of animal.

(11) Bad debts [Section 36(1)(vii) and section 36(2)] - These can be deducted subject to the following conditions:

- (a) The debts or loans should be in respect of a business which was carried on by the assessee during the relevant previous year.
- (b) The debt should have been taken into account in computing the income of the assessee of the previous year in which such debt is written off or of an earlier previous year or should represent money lent by the assessee in the ordinary course of his business of banking or money lending.

Deduction under section 36(1)(vii) for bad debts limited to the amount by which bad debts exceed credit balance in the provision for doubtful debts account under section 36(1)(viii)

Under section 36(1)(vii), bad debt actually written off as irrecoverable in the books of account of the assessee is deductible. However, in the case of entities for which provision for bad and doubtful debts is allowable under section 36(1)(viii), deduction for bad debts written off under said clause (vii) shall be limited to the amount by which the bad debt written off exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(viii). This is provided in the proviso to section 36(1)(vii).

Further, the provisions of section 36(1)(vii) are subject to the provisions of section 36(2). Section 36(2)(v) provides that where the debt or part thereof relates to advances made by an assessee, to which section 36(1)(viii) applies, no deduction shall be allowed unless the assessee has debited the amount of such debt or part of such debt in that previous year to the provision for bad and doubtful debts account made under section 36(1) (viii).

Explanation 2 to section 36(1)(vii) states that for the purposes of the proviso to section 36(1)(vii) and section 36(2)(v), only one account as referred to therein shall be made in respect of provision for bad and doubtful debts under section 36(1)(vii) and such account shall relate to all types of advances, including advances made by rural branches.

Therefore, in the case of an assessee to which section 36(1)(vii) applies, the amount of deduction in respect of the bad debts actually written off under section 36(1)(vii) shall be limited to the amount by which such bad debts exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1)(vii) without any distinction between rural advances and other advances.

Illustration 11

The following are the particulars in respect of a scheduled bank incorporated in India -

	<i>Particulars</i>	<i>₹ in lakh</i>
(i)	Provision for bad and doubtful debts under section 36(1)(vii) upto A.Y.2014-15	100
(ii)	Gross Total Income of A.Y.2015-16 [before deduction under section 36(1)(vii)]	800
(iii)	Aggregate average advances made by rural branches of the bank	300
(iv)	Bad debts written off (for the first time) in the books of account (in respect of urban advances only) during the previous year 2014-15	210

Compute the deduction allowable under section 36(1)(vii) for the A.Y.2015-16.

Solution

<i>Particulars</i>	<i>₹ in lakh</i>	
Bad debts written off (for the first time) in the books of account		210
Less: Credit balance in the "Provision for bad and doubtful debts" under section 36(1)(vii) as on 31.3.2015		
(i) Provision for bad and doubtful debts under section 36(1)(vii) upto A.Y.2014-15	100	
(ii) Current year provision for bad and doubtful debts under section 36(1)(vii) [7.5% of ₹ 800 lakhs + 10% of ₹ 300 lakhs]	90	190
Deduction under section 36(1)(vii) in respect of bad debts written off for A.Y.2015-16		20

Deduction of differential amount of debts due as bad debts in the year of recovery, to the extent of deficiency in recovery

Further, if on the final settlement the amount recovered in respect of any debt, where deduction had already been allowed, falls short of the difference between the debt due and the amount of debt allowed, the deficiency can be claimed as a deduction from the income of the previous year in which

the ultimate recovery out of the debt is made. It is permissible for the Assessing Officer to allow deduction in respect of a bad debt or any part thereof in the assessment of a particular year and subsequently to allow the balance of the amount, if any, in the year in which the ultimate recovery is made, that is to say, when the final result of the process of recovery comes to be known.

Recovery of a bad debt subsequently [Section 41(4)] - If a deduction has been allowed in respect of a bad debt under section 36, and subsequently the amount recovered in respect of such debt is more than the amount due after the allowance had been made, the excess shall be deemed to be the profits and gains of business or profession and will be chargeable as income of the previous year in which it is recovered, whether or not the business or profession in respect of which the deduction has been allowed is in existence at the time.

For example, let us assume that a debt of ₹ 10,000 was claimed as a bad debt in the previous year 2013-14. However, the Assessing Officer allowed only a sum of ₹ 5,000 as bad debt. If in the previous year 2014-15, a sum of ₹ 4,000 is recovered ultimately in respect of the debt, then the Assessing Officer should allow a deduction in respect of the deficiency namely, ₹ 1,000 i.e., the difference between the amount ultimately recovered and the amount disallowed earlier under Section 36(1)(vii). If on the other hand, the sum ultimately recovered is ₹ 6,000 then there will be a liability, under section 41(4) in respect of sum of ₹ 1,000, which would be deemed to be the profits and gains of business or profession. Such a liability under section 41(4) would arise even if the business or profession in respect of which deduction has been allowed is not in existence at that time.

(12) Special provision for bad and doubtful debts in cases of Rural Branches of Scheduled Banks [Section 36(1)(viia)]

- (a) In the case of a scheduled bank which is not a bank incorporated by or under the laws of a country outside India or a non-scheduled bank, the following deductions will be allowed:
- (i) an amount not exceeding 7.5% of the total income (computed before making any deduction under this clause and Chapter VI-A), and
 - (ii) an amount not exceeding 10% of the aggregate average advances made by the rural branches of such bank computed in the manner prescribed by the CBDT.
- (b) A scheduled bank or a non-scheduled bank referred to in (a) above or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank shall, at its option, be allowed a further deduction in excess of the limits specified in the foregoing provisions, for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the Central Government. It is also provided that this deduction shall not be allowed unless such income has been disclosed in the return of income under the head "Profits and gains of business or profession".

Scheduled Bank : It refers to the State Bank of India or any of its subsidiaries or any of the nationalised banks and would also include any other bank which is listed in the Second Schedule to the Reserve Bank of India Act, 1935.

Non-Scheduled Bank : This refers to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 which is not a scheduled bank.

Rural branch : This means a branch of a scheduled bank or a non-scheduled bank situated in a place which has a population of not more than 10,000 according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

(c) **Foreign Banks** : In the case of foreign banks the deduction will be an amount not exceeding 5% of the total income (computed before making any deduction under this clause and Chapter VI-A).

(d) A public financial institution, a State Financial Corporation and a State Industrial Investment Corporation will be entitled to a deduction in respect of provision for bad and doubtful debts made out of profits. The maximum amount to be allowed as a deduction will be limited to 5% of its total income before making any deduction in respect of the provision for bad and doubtful debt or in respect of any deduction in Chapter VI-A.

"Public Financial Institution" shall have the meaning assigned to it in section 4A of the Companies Act, 1956.

"State Financial Corporation" means a financial corporation established under section 3 or section 3A or an institution notified under section 46 of the State Financial Corporations Act, 1951.

"State Industrial Investment Corporation" means a Government company within the meaning of Section 617 of the Companies Act engaged in the business of providing long-term finance for industrial projects and eligible for deduction under clause (viii) of this sub-section.

Co-operative bank, primary agricultural credit society and primary co-operative agricultural and rural development bank have the same meanings assigned in *Explanation* to section 80P(4).

(13) Special deduction to Specified Entities engaged in eligible business [Section 36(1)(viii)]

(a) This section provides deduction in respect of any special reserve created and maintained by a specified entity.

(b) The quantum of deduction, however, should not exceed 20% of the profits derived from eligible business computed under the head "Profits and gains of business or profession" carried to such reserve account.

(c) The eligible business for different entities specified are given in the table below –

	Specified entity	Eligible business
1.	Financial Corporation specified in section 4A of the Companies Act, 1956 Financial corporation which is a public sector company Banking company Co-operative bank (other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank)	Business of providing long-term finance for - (i) industrial or agricultural development or (ii) development of infrastructure facility in India; or (iii) development of housing in India.

2.	A housing finance company	Business of providing long-term finance for the construction or purchase of houses in India for residential purposes.
3.	Any other financial corporation including a public company	Business of providing long-term finance for development of infrastructure facility in India.

(d) However, where the aggregate amount carried to such reserve account exceeds twice the amount of paid up share capital and general reserve, no deduction shall be allowed in respect of such excess.

(e) Infrastructure facility has been defined to mean -

- (a) (1) an infrastructure facility as defined in the Explanation to clause (i) of sub-section (4) of section 80-IA i.e.
 - (i) a road including toll road, a bridge or a rail system;
 - (ii) a highway project including housing or other activities being an integral part of the highway project;
 - (iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system; and
 - (iv) a port, airport, inland waterway or inland port or a navigational channel in the sea
- (2) any other public facility of a similar nature as may be notified by the CBDT in this behalf in the Official Gazette and which fulfils the prescribed conditions;
- (b) an undertaking referred to in clause (ii) or clause (iii) or clause (iv) of sub-section (4) of section 80-IA (i.e. an undertaking providing telecommunication services, an undertaking developing, developing and operating, maintaining and operating an industrial park or SEZ notified by the Central Government, an undertaking generating, distributing or transmitting power); and
- (c) an undertaking referred to in sub-section (10) of section 80-IB i.e. an undertaking developing and building housing projects approved by a local authority.

Conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility [Notification No.187/2006 dated 20.7.2006]: Rule 6ABAA has been inserted in the Income-tax Rules, 1962 which specifies the conditions to be fulfilled by a public facility to be eligible to be notified as an infrastructure facility in accordance with the provisions of clause (d) of the Explanation to clause (viii) of sub-section (1) of section 36. The conditions specified therein are -

- (a) it is owned by a company registered in India or by a consortium of such companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act;

(b) it has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for (i) developing or (ii) operating and maintaining or (iii) developing, operating and maintaining a new infrastructure facility similar in nature to an infrastructure facility referred to in the *Explanation* to section 80-IA(4)(i);

(c) it has started or starts operating and maintaining such infrastructure facility on or after 1st April, 1995.

Notification of public facilities as infrastructure facility for the purpose of section 36(1)(viii) [Notification No. 188/2006, dated 20.7.2006]

The following public facilities have been notified by the CBDT as infrastructure facility for purposes of section 36(1)(viii)-

- (1) Inland Container Depot and Container Freight Station notified under the Customs Act, 1962
- (2) Mass Rapid Transit system
- (3) Light Rail Transit system
- (4) Expressways
- (5) Intra-urban or semi-urban roads like ring roads or urban by-passes or flyovers
- (6) Bus and truck terminals
- (7) Subways
- (8) Road dividers
- (9) Bulk Handling Terminals which are developed or maintained or operated for development of rail system
- (10) Multilevel Computerised Car Parking.

Deduction in respect of income from long-term finance for development of infrastructure facilities - The deduction will now be available also to approved financial corporations providing long-term finance for development of infrastructure facilities in India. For this purpose, the expression "infrastructure facility" shall have the meaning assigned to it in section 80-IA.

(14) Expenses on family planning [Section 36(1)(ix)] - Any expenditure of revenue nature bona fide incurred by a company for the purpose of promoting family planning amongst its employees will be allowed as a deduction in computing the company's business income; where, the expenditure is of a capital nature, one-fifth of such expenditure will be deducted in the previous year in which it was incurred and in each of the four immediately succeeding previous years. This deduction is allowable only to companies and not to other assessees. The assessee would be entitled to carry forward and set off the unabsorbed part of the allowance in the same way as unabsorbed depreciation. The capital expenditure on promoting family planning will be treated in the same way as capital expenditure for scientific research for purposes of dealing with the profit or loss on the sale or transfer of the asset including a transfer on amalgamation.

(15) Deduction for expenditure incurred by entities established under any Central, State or Provincial Act [Section 36(1)(xii)]

Any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate, by whatever name called, if –

- (a) it is constituted or established by a Central, State or Provincial Act;
- (b) such corporation or body corporate is notified by the Central Government in the Official Gazette for this purpose having regard to the objects and purposes of the Act;
- (c) the expenditure is incurred for the objects and purposes authorised by the Act under which it is constituted and established.

Accordingly, the Central Government has notified the Oil Industry Development Board for the purpose of deduction under section 36(1)(xii).

(16) Deduction in respect of banking cash transaction tax [Section 36(1)(xiii)]

- (a) The Finance Act, 2005 had, through Chapter VII, introduced a tax called banking cash transaction tax, as an anti tax-evasion measure, in respect of every taxable banking transaction entered into on or after 1.6.2005.
- (b) Section 36(1)(xiii) provides for deduction of any amount of banking cash transaction tax paid by the assessee during the previous year on the taxable banking transactions entered into by him.

Note – Banking Cash Transaction Tax is not chargeable in respect of any taxable banking transaction entered into on or after 1.4.2009.

(17) Deduction of contribution by a public financial institution to Credit guarantee fund trust for small industries [Section 36(1)(xiv)]

- (i) Section 36(1)(xiv) provides for deduction of any sum paid by a public financial institution by way of contribution to such credit guarantee fund trust for small industries notified by the Central Government in the Official Gazette.
- (ii) Public financial institution has the meaning assigned to it in section 4A of the Companies Act, 1956.

(18) Deduction of securities transaction tax paid [Section 36(1)(xv)]: The amount of securities transaction tax paid by the assessee during the year in respect of taxable securities transactions entered into in the course of business shall be allowed as deduction under section 36 subject to the condition that such income from taxable securities transactions is included under the head 'Profits and gains of business or profession'. Thus, securities transaction tax paid would be allowed as a deduction like any other business expenditure.

(19) Deduction for commodities transaction tax paid in respect of taxable commodities transactions [Section 36(1)(xvi)]

- (a) The Finance Act, 2013 has introduced a new tax called Commodities Transaction Tax (CTT) to be levied on taxable commodities transactions entered into in a recognised association, vide Chapter VII of the Finance Act, 2013.

(b) For this purpose, a 'taxable commodities transaction' means a transaction of sale of commodity derivatives in respect of commodities, other than agricultural commodities, traded in recognised associations.

(c) CTT is to be levied at 0.01% on sale of commodity derivative. CTT is to be paid by the seller.

(d) A "commodity derivative" means –

- (1) A contract for delivery of goods which is not a ready delivery contract
- (2) A contract for differences which derives its value from prices or indices of prices -
 - (i) of such underlying goods; or
 - (ii) of related services and rights, such as warehousing and freight; or
 - (iii) with reference to weather and similar events and activities having a bearing on the commodity sector.

(e) Consequently, clause (xvi) of section 36(1) provides that an amount equal to the CTT paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year shall be allowable as deduction, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession".

(xx) Residuary Expenses [Section 37]

(1) Revenue expenditure incurred for purposes of carrying on the business, profession or vocation - This is a residuary section under which only business expenditure is allowable but not the business losses, e.g., those arising out of embezzlement, theft, destruction of assets, misappropriation by employees etc. (These are allowable under section 29 as losses incidental to the business). The deduction is limited only to the amount actually expended and does not extend to a reserve created against a contingent liability.

(2) Conditions for allowance : The following conditions should be fulfilled in order that a particular item of expenditure may be deductible under this section :

- (a) The expenditure should not be of the nature described in sections 30 to 36.
- (b) It should have been incurred by the assessee in the accounting year.
- (c) It should be in respect of a business carried on by the assessee the profits of which are being computed and assessed.
- (d) It must have been incurred after the business was set up.
- (e) It should not be in the nature of any personal expenses of the assessee.
- (f) It should have been laid out or expended wholly and exclusively for the purposes of such business.
- (g) It should not be in the nature of capital expenditure. (The principles to be followed for distinguishing capital expenditure from revenue are discussed below.)

- (h) The expenditure should not have been incurred by the assessee for any purpose which is an offence or is prohibited by law.

This section is thus limited in scope. It does not permit an assessee to make all deductions which a prudent trader would make in ascertaining his own profit. It might be observed that the section requires that the expenditure should be wholly and exclusively laid out for purpose of the business but not that it should have been necessarily laid out for such purpose. There fore, expenses wholly and exclusively laid out for the purpose of trade are, subject to the fulfilment of other conditions, allowed under this section even though the outlay is unnecessary.

(3) For determining whether an expenditure is of the nature contemplated by the foregoing provisions of law the following tests should be applied:

- (i) **‘Character as a trader’**: The expenditure should be incurred by the assessee in his character as a trader.
- (ii) **‘Voluntarily expended on grounds of commercial expediency’** : A sum of money expended, not out of necessity but with a view to getting a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency and in order indirectly to facilitate the carrying on of the business may yet be expended wholly and exclusively for purposes of the trade [*Atherton v British Insulated and Helsby Ltd.* 10 LTC. 115 (H.L.)].
- (iii) **‘Direct concern and direct purpose’** : In order to ascertain whether the expenditure has been incurred wholly and exclusively for the purpose of the business one must look to the direct concern and direct purpose for which the money is laid out and not the remote or indirect result which may possibly motivate or flow from the expenditure.
- (iv) **‘Purpose of the assessee’s own business’** : The expenditure should be primarily incurred for the assessee’s own business. Notwithstanding this proposition so long as the expenditure is for the whole and exclusive purpose of the assessee’s trade the mere fact that the expenditure incidentally obtains some advantage to the assessee in some character other than that of a trader, would not detract the effect of the finding that the expenditure was wholly and exclusively incurred for purpose of the assessee’s business.
- (v) **‘Unremunerative expenditure’** : The expenditure need not be incurred solely for the purpose of earning profit in the year of account. For example, the cost of repairs or advertisement or expenses on a foreign tour by the managing directors would be deductible even though the income therefrom would be earned in future years.
- (vi) **‘Treatment in assessee’s accounts’** : The way in which an item of expenditure is treated in the assessee’s accounts is not a conclusive evidence against or in favour of the assessee.

Payment out of profits and payments ascertained by reference to profits : When a trader makes a payment which is computed in relation to profits the question that arises is : Does the payment represent a mere division of profit with another person or is it an item of expenditure the amount of which is ascertained by reference to the profits? The payment would be allowable in the second case but not in the first.

(4) Distinction between capital and revenue expenditure: The line of demarcation between capital and revenue expenditure is very thin and the ultimate conclusion on the nature of the expenditure is always a mixed question of law and fact. In deciding whether an expenditure is of a revenue or a capital nature, one must take into consideration the nature and ordinary course of the business of the assessee and the object for which the expenditure had been incurred.

Whether a particular item of expenditure is incurred for the purpose of the business or not must be viewed in the larger context of business necessity and expediency. For this purpose, one must look not to the documents but also the surrounding circumstances so as to arrive at a decision as to what exactly is the real nature of the transaction from the commercial point of view.

It is often very difficult to lay down a test of a comprehensive nature which would be of universal application. Different tests have to be applied from the business point of view and then conclusions must be arrived at on the question whether, on a fair consideration of the whole situation as evident from the facts, the expenditure in question incurred in a particular case is of revenue nature or of a capital nature. The following broad principles have been evolved by the decisions of the various courts from time to time. These principles are neither exhaustive nor are they intended to be. They would serve only as guidelines to decide any problem arising in regard to the determination of the capital or revenue of a particular item [*Hylam Ltd. v CIT* [1913] 87 ITR 310 (A.P.)].

- (i) If the expenditure is for the initial outlay or for acquiring or bringing into existence any asset or advantage of an enduring benefit to the business of the assessee or for extension of the business which is already in existence or for substantial replacement of any existing business asset it must be treated as capital expenditure. The Supreme Court has reiterated the above principle in *CIT v. Jalan Trading Co. (P) Ltd.* [1985] 23 Taxman (SC).
- (ii) If, however, the expenditure, although incurred for the purpose of the business that too for acquiring an asset or advantage, is for running the business or for working out that asset with a view to producing profits, it would be a revenue expenditure. The expenditure incurred for the purpose of carrying on the business undertaking would be of a revenue nature. The expenditure which has to be incurred by an assessee in the ordinary course of his business, to enable him to carry on his trading operations is normally to be considered to be of a revenue nature. The expenditure by the assessee cannot be considered to be capital in nature merely because of the fact that the amount involved is large. The quantum of the expenditure cannot go to affect or alter the real nature and character of expenditure.
- (iii) In cases where the outgoing of money spent by the assessee is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process of operations and not for the acquisition of any asset of a permanent character the possession of which is a condition precedent to the running of the business, then such an item of payment would constitute an expenditure of a revenue nature.
- (iv) Any special knowledge, technical know-how or patent or trade mark constitutes an asset and if such an asset is acquired on payment for its use and exploitation for a limited

period in the business and the acquisition is not of an asset or advantage of an enduring nature and at the end of the stipulated period the asset or advantage reverts back intact to the giver of the special knowledge or the owner of the patent, trade mark or copyright, it would constitute an expenditure of a revenue nature. In this context, it may be noted that a payment made to ward off competition in business to a rival would constitute a capital expenditure if the object of making that payment is to derive an advantage by eliminating competition over some length of time. The same result would not follow if there is no certainty of the duration of the advantage and the same can be put to an end at any point of time. How long the period of contemplated advantage or the benefit should be in order to constitute benefit of an enduring nature would depend upon the facts and circumstances of each individual case. Although enduring benefit need not be of an everlasting character, it should not be so transitory and ephemeral that it may be terminated at any time at the volition of any of the parties to the contract.

- (v) In cases of acquisition of a capital asset, it is immaterial whether the price for it is paid by the assessee once and for all in lumpsum or periodically and also whether it is paid out of capital or income or is linked with the total sales or the turnover of the business. In such a case, the expenditure or outgoing would constitute payment of a capital nature although it may indirectly be linked to or is paid out of revenue profit or sales.
- (vi) In cases where the amount paid for acquisition of an asset of an enduring nature is settled, by the mere fact that the amount so settled is chalked out into various small amounts or periodical instalments the capital nature of the transaction or expenditure would not in any way be affected nor the fact that the payment is made in instalments or in small amounts would in any way alter the nature of the expenditure from capital to revenue. In other words, the magnitude of the payment and its periodicity would not be deciding factors for determining the capital or revenue nature of any particular payment.
- (vii) A lumpsum amount paid for liquidating recurring claims would generally be of a revenue nature; it would not cease to be a revenue expenditure or get converted into capital expenditure merely because its payment is spread over a number of years. In such a case it is the intention and the object for which the assets are acquired that determine the nature of the expenditure incurred over it, and not the mode and the manner in which the payment is made nor is it in any way related to or determined by the source of such payment.
- (viii) If the expenditure in question is recurring and is incurred by the assessee during the ordinary course of the business or manufacture, it would normally constitute a revenue expenditure.
- (ix) An asset or advantage of an enduring nature resulting in capital expenditure does not mean that such an asset should last forever; if the capital asset is, by its very nature, a short lived one, the expenditure incurred over it does not on that account cease to be a capital expenditure.
- (x) It is nowhere stipulated in the law that if a benefit of enduring nature is obtained, the expenditure for securing it must be treated as a capital expenditure. If the advantage or the benefit acquired by the assessee is to get stock-in-trade of a business it would constitute a revenue; but if what is acquired by the assessee is not the advantage of getting his current or trading assets directly but of something which requires to be

processed before it is converted into stock-in-trade, the expenditure incurred over it would constitute a capital expenditure.

- (xi) Further, an item of disbursement may be regarded as capital expenditure when it is referable to fixed capital or a capital asset; it is a revenue expenditure when it is referable to circulating capital or stock in trade. Expenditure which relates to the framework of the taxpayer's business is a capital expenditure. Expenditure incurred for the termination of trading relationship in order to avoid losses occurring in future though that relationship, whether pecuniary loss or commercial inconvenience, is a revenue expenditure. Expenditure incurred for the initial starting of the business before its setting up for substantial expansion and also expenditure incurred after the discontinuance of the business would be of a capital nature.

The capital or revenue character of a particular item must be decided from the facts and circumstances of each case and must be based upon the principles of law applicable to those facts. The fact that a particular transaction is treated by the parties as capital or revenue in nature or is called a sale, instead of being an agreement to use or let out the particular asset would not convert the capital or revenue character of the transaction. Similarly, the entries made by the parties concerned in their books of account or other documents would not always be indicative or conclusive, as to what the real nature of the transaction is based upon the above principles, the capital or revenue character of a particular expenditure will have to be decided in every case.

Instances of revenue expenditure: Payment made for the use of goodwill, use of quota rights or in the case of a hotel or restaurant business the cost of table linen, crockery, pots is of a revenue expenditure. The cost of dredging carried on by a harbor authority for the purpose of keeping the channels clear for shipping is also of revenue expenditure. Expenditure incurred by a surgeon or businessman on a study tour abroad to acquire knowledge of the latest techniques would be on revenue account.

Circular No.6/2007 dated 11.10.2007 clarifies the issue of allowability of the claim of harvesting and transportation expenses incurred by the Co-operative sugar mills for procuring sugarcane from farmers, who are members of such Co-operative Sugar Mills and who are bound under an agreement to supply the sugarcane exclusively to the concerned sugar Mill.

The issue of allowability of such expenses in the case of co-operative sugar mills has been examined by the CBDT. These expenses are incurred by the Sugar Mills for ensuring an adequate and sustained supply of freshly cut sugarcane that is an essential input for the continuous running of such Mills. These expenses are, therefore, incurred for commercial expediency and are *prima facie* wholly and exclusively for the purpose of business. Such expenses are, therefore, allowable in the computation of the income of the co-operative sugar mills.

Instances of capital expenditure: Expenditure on improvement to property as distinguished from mere repairs or that which is incurred by a company in raising loans or issuing debentures for capital outlay would be capital expenditure if they are incurred before the business is set up. Legal expenses incurred in connection with the mortgages of the premises belonging to the assessee in which the assessee carries on his business are also capital expenditure.

(5) **Explanation 1 to section 37(1)** - This *Explanation* provides that any expenditure incurred by the assessee for any purpose which is an offence or is prohibited by law shall not be allowed as a deduction or allowance.

Inadmissibility of expenses incurred in providing freebies to medical practitioner by pharmaceutical and allied health sector industry [Circular No. 5/2012 dated 1-8-2012]

Section 37(1) provides for deduction of any revenue expenditure (other than those falling under sections 30 to 36) from the business income if such expense is laid out or expended wholly or exclusively for the purpose of business or profession. However, the Explanation below section 37(1) denies claim of any such expenses, if the same has been incurred for a purpose which is either an offence or prohibited by law.

The CBDT, considering the fact that the claim of any expense incurred in providing freebies to medical practitioner is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, has clarified that the expenditure so incurred shall be inadmissible under section 37(1) of the Income-tax Act, 1961, being an expense prohibited by the law. The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies and claimed it as a deductible expense in its accounts against income.

This circular has also clarified that a sum equivalent to value of freebies enjoyed by the aforesaid medical practitioner or professional associations is also taxable as business income or income from other sources, as the case may be, depending on the facts of each case.

(6) Disallowance of CSR expenditure [Explanation 2 to Section 37(1)]

(i) *Section 135 of the Companies Act, 2013 read with Schedule VII thereto and Companies (Corporate Social Responsibility) Rules, 2014 are the special provisions under the new company law regime imposing mandatory CSR obligations.*

Mandatory CSR obligations under section 135:

- *Every company, listed or unlisted, private or public, having a -*
 - *net worth of ₹ 500 crores or more [Net worth criterion]; or*
 - *turnover of ₹ 1,000 crores or more [Turnover criterion]; or*
 - *a net profit of ₹ 5 crores or more [Net Profit criterion]**during any financial year to constitute a CSR Committee of the Board;*
- *CSR Committee has to formulate CSR policy and the same has to be approved by the Board;*
- *Such company to undertake CSR activities as per the CSR Policy;*
- *Such company to spend in every financial year, at least 2% of its average net profits made in the immediately three preceding financial years, on the CSR activities specified in Schedule VII to the Companies Act, 2013.*

(ii) *As per Rule 4 of the Companies (CSR) Rules, 2014, the following expenditure are not*

considered as CSR activity for the purpose of section 135:

- Expenditure on activities undertaken in pursuance of normal course of business;
- Expenditure on CSR activities undertaken outside India;
- Expenditure which is exclusively for the benefit of the employees of the company or their families; and
- Contributions to political parties.

(iii) Under section 37(1) of the Income-tax Act, 1961, only expenditure, not covered under sections 30 to 36, and incurred wholly and exclusively for the purposes of the business is allowed as a deduction while computing taxable business income. The issue under consideration is whether CSR expenditure is allowable as deduction under section 37.

(iv) It has now been clarified that for the purposes of section 37(1), any expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013 shall not be deemed to have been incurred for the purpose of business and hence, shall not be allowed as deduction under section 37.

(v) The rationale behind the disallowance is that CSR expenditure, being an application of income, is not incurred wholly and exclusively for the purposes of carrying on business.

(vi) However, the Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that CSR expenditure, which is of the nature described in sections 30 to 36, shall be allowed as deduction under those sections subject to fulfillment of conditions, if any, specified therein.

(7) Advertisements in souvenirs of political parties: Section 37(2B) disallows any deduction on account of advertisement expenses representing contributions made by any person carrying on business or profession in computing the profits and gains of the business or profession. It has specifically been provided that this provision for disallowance would apply notwithstanding anything to the contrary contained in section 37(1). In other words, the expenditure representing contribution for political purposes would become disallowable even in those cases where the expenditure is otherwise incurred by the assessee in his character as a trader and the amount is wholly and exclusively incurred for the purpose of the business. Accordingly, a taxpayer would not be entitled to any deduction in respect of expenses incurred by him on advertisement in any souvenir, brochure, tract or the like published by any political party, whether it is registered with the Election Commission of India or not.

Illustration 12

Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31.03.2015 is ₹ 15,25,890 after debiting the following items:

S.No.	Particulars	₹
1.	Purchase price of raw material used for the purpose of in-house research and development	1,80,000

2.	Purchase price of asset used for in-house research and development wrongly debited to profit and loss account:	
	(1) Land	5,00,000
	(2) Building	3,00,000
3.	Expenditure incurred on notified agricultural extension project	1,50,000
4.	Expenditure on notified skill development project:	
	(1) Purchase of land	2,00,000
	(2) Expenditure on training for skill development	2,50,000
5.	Expenditure incurred on advertisement in the souvenir published by a political party	75,000

Compute the income under the head "Profits and gains of business or profession" for the A.Y. 2015-16 of Isac Ltd.

Answer

Computation of income under the head "Profits and gains of business or profession" for the A.Y.2015-16

Particulars		₹	₹
Net profit as per profit and loss account			15,25,890
Add:	Items debited to profit and loss account, but to be disallowed		
	Purchase price of Land used in in-house research and development - being capital expenditure not allowable as deduction under section 35	5,00,000	
	Purchase price of building used in in-house research and development - being capital expenditure, 100% of which is allowable as deduction u/s 35(1)(iv) read with section 35(2)	-	
	Expenditure incurred on notified agricultural extension project (to be treated separately)	1,50,000	
	Expenditure incurred on notified skill development project - Purchase of land - being capital expenditure not qualifying for deduction under section 35CCD	2,00,000	
	Expenditure incurred on notified skill development project - Expenditure on training for skill development (to be treated separately)	2,50,000	
	Expenditure incurred on advertisement in the souvenir published by a political party not allowed as deduction as per section 37(2B)	75,000	
		<u>75,000</u>	<u>11,75,000</u>
			27,00,890

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Less:	Purchase price of raw material used for in-house research and development qualifies for 200% deduction under section 35(2AB). Since, it is already debited to profit and loss account balance 100% is allowed.	1,80,000	
Less:	Expenditure incurred on notified agricultural extension project qualifies for 150% deduction under section 35CCC.	2,25,000	
Less:	Expenditure incurred on training for skill development in a notified skill development project qualifies for 150% deduction under section 35CCD.	<u>3,75,000</u>	<u>7,80,000</u>
	Profit and gains from business		<u>19,20,890</u>

Note : The expenditure incurred on advertisement in the souvenir published by a political party is disallowed as per section 37(2B) while computing income under the head "Profit and Gains of Business or Profession" but the same would be allowed as deduction under section 80GGB from the gross total income of the company.

(xxi) Clarification regarding treatment of expenditure incurred for development of roads/highways in Build-Operate-Transfer (BOT) agreements under the Income-tax Act, 1961 [Circular No. 09/2014, dated 23.04.2014]

The CBDT has, vide this Circular, clarified the tax treatment of expenditure incurred on development and construction of infrastructural facilities like roads/highways on Build-Operate-Transfer (BOT) basis with right to collect toll - whether the same is entitled to depreciation under section 32(1)(ii) or can be amortized by treating it as an allowable business expenditure under the relevant provisions of the Income- tax Act, 1961.

Generally, the BOT basis projects are entered into between the developer and the government or the notified authority, on the following terms:

- (i) In such projects, the developer, in terms of concessionaire agreement with Government or its agencies, is required to construct, develop and maintain the infrastructural facility of roads/highways which, inter alia, includes laying of road, bridges, highways, approach roads, culverts, public amenities etc. at its own cost and its utilization thereof for a specified period.
- (ii) The possession of land is handed over to the assessee (i.e., the developer) by the Government/ notified authority for the purpose of construction of the project without any actual transfer of ownership. The assessee, therefore, has only a right to develop and maintain such asset. It also enjoys the benefits arising from the use of asset through collection of toll for a specified period, without having actual ownership over such asset. Therefore, the rights in the land remain vested with the Government/notified agencies.
- (iii) Since the assessee does not hold any rights in the project except recovery of toll fee to recoup the expenditure incurred, it cannot be treated as an owner of the property, either wholly or partly, for purposes of allowability of depreciation under section 32(1)(ii). Thus,

claim of depreciation on tollways is not allowable due to non-fulfillment of ownership criteria in such cases.

- (iv) *Where the assessee incurs expenditure on a project for development of roads/highways, it is entitled to recover cost incurred towards development of such facility (comprising of construction cost and other pre-operative expenses) during construction period. Further, expenditure incurred by the assessee on such BOT projects brings to it an enduring benefit in the form of right to collect the toll during the period of agreement.*

The Supreme Court, in Madras Industrial Investment Corporation Ltd. vs. CIT 225 ITR 802, allowed the spreading over of liability over a number of years on the ground that there was continuing benefit to the company over a period. Therefore, analogously, expenditure incurred on an infrastructure project for development of roads/highways under BOT agreement may be treated as having been made/incurred for the purposes of business or profession of the assessee and same shall be allowed to be spread during the tenure of concessionaire agreement.

In view of the above, the CBDT, in exercise of the powers conferred under section 119, clarifies that the cost of construction on development of infrastructure facility, being roads/highways under BOT projects, may be amortized and claimed as allowable business expenditure under the Act in the following manner:

- (i) *The amortization allowable may be computed at the rate which ensures that the whole of the cost incurred in creation of infrastructural facility of road/highway is amortised evenly over the period of concessionaire agreement after excluding the time taken for creation of such facility.*
- (ii) *Where an assessee has claimed any deduction out of initial cost of development of infrastructure facility of roads/highways under BOT projects in earlier years, the total deduction so claimed for the assessment years prior to assessment year under consideration may be deducted from the initial cost of infrastructure facility of roads/highways and the cost so reduced shall be amortised equally over the remaining period of toll concessionaire agreement.*

The clarification given in this Circular is applicable only to those infrastructure projects for development of road/highways on BOT basis where ownership is not vested with the assessee under the concessionaire agreement.

3.6 Inadmissible Deductions [Section 40]

By dividing the assessee into distinct groups, this section places absolute restraint on the deductibility of certain expenses as follows:

- (i) **Section 40(a)** - In the case of any assessee, the following expenses are not deductible:

(1) Any interest (not being interest on loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable, -

(a) outside India;

(b) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid ***on or before the due date of filing of return specified under section 139(1)***. It is also provided that where in respect of any such sum, where tax has been deducted in any subsequent year, ***or has been deducted in the previous year but paid after the due date of filing of return under section 139(1)***, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

(2) Section 40(a)(ia) provides that ***30% of any sum payable to a resident, on which tax is deductible at source under Chapter XVII-B***, shall be disallowed if –

(i) such tax has not been deducted; or

(ii) such tax, after deduction, has not been paid on or before the due date specified in section 139(1).

If in respect of such sum, tax has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in section 139(1), ***30% of such sum*** shall be allowed as deduction in computing the income of the previous year in which such tax has been paid.

If, for instance, tax on royalty paid to Mr. A, a resident, has been deducted during the previous year 2014-15, the same has to be paid by 31st July/30th September 2015, as the case may be. Otherwise, ***30% of royalty paid*** would be disallowed in computing the income for A.Y.2015-16. If in respect of such royalty, tax deducted during the P.Y.2014-15 has been paid after 31st July/30th September, 2015, ***30% of such royalty would be allowed as deduction in the year of payment.***

Illustration 13

XYZ Ltd. made the following payments in the month of March 2015 to residents without deduction of tax at source. What would be the tax consequence for A.Y.2015-16, assuming that the resident payees in all the cases mentioned below, have not paid the tax, if any, which was required to be deducted by XYZ Ltd.?

	<i>Particulars</i>	<i>Amount in ₹</i>
(1)	<i>Salary to its employees</i>	<i>15,00,000</i>
(2)	<i>Non-compete fees to Mr. X</i>	<i>70,000</i>
(3)	<i>Directors' remuneration</i>	<i>25,000</i>

Would your answer change if XYZ Ltd. has deducted tax on the above in April, 2015 from subsequent payments made to these persons and remitted the same in July, 2015?

Answer

Non-deduction of tax at source on any payment on which tax is deductible as per the

provisions of Chapter XVII-B would attract disallowance under section 40(a)(ia). Therefore, non-deduction of tax at source on salary payment on which tax is deductible under section 192 and non-compete fees and directors' remuneration on which tax is deductible under section 194J, would attract disallowance@30% of sum paid under section 40(a)(ia). Therefore, the amount to be disallowed under section 40(a)(ia) while computing business income for A.Y.2015-16 is as follows –

	Particulars	Amount paid in ₹	Disallowance u/s 40(a)(ia) @ 30% of sum paid (₹)
(1)	Salary [tax is deductible under section 192]	15,00,000	4,50,000
(2)	Non-compete fees to Mr. X [tax is deductible under section 194J]	70,000	21,000
(3)	Directors' remuneration [tax is deductible under section 194J without any threshold limit]	25,000	7,500
Disallowance under section 40(a)(ia)			4,78,500

If the tax is deducted and paid in the next year i.e., P.Y.2015-16, the amount of ₹ 4,78,500 would be allowed as deduction while computing the business income of A.Y.2016-17.

Section 201 provides that the payer (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident payee shall not be deemed to be an assessee-in-default in respect of such tax if such resident payee –

- (i) has furnished his return of income under section 139;
- (ii) has taken into account such sum for computing income in such return of income; and
- (iii) has paid the tax due on the income declared by him in such return of income,

and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

The date of deduction and payment of taxes by the payer shall be deemed to be the date on which return of income has been furnished by the resident payee.

Consequently, in cases where such person responsible for deducting tax is not deemed to be an assessee-in-default on account of payment of taxes by the resident payee, it shall be deemed that the payer has deducted and paid the tax on such sum on the date of furnishing return of income by the resident payee.

Since the date of furnishing the return of income by the resident payee is taken to be the date on which the payer has deducted tax at source and paid the same, **30% of such expenditure/payment** in respect of which the payer has failed to deduct tax at source shall be

disallowed under section 40(a)(ia) in the year in which the said expenditure is incurred. However, **30% of such expenditure** will be allowed as deduction in the subsequent year in which the return of income is furnished by the resident payee, since tax is deemed to have been deducted and paid by the payer in that year.

Disallowance of any sum paid to a resident at any time during the previous year without deduction of tax under section 40(a)(ia) [Circular No.10/2013, dated 16.12.2013]

There have been conflicting interpretations by judicial authorities regarding the applicability of provisions of section 40(a)(ia), with regard to the amount not deductible in computing the income chargeable under the head 'Profits and gains of business or profession'. Some court rulings have held that the provisions of disallowance under section 40(a)(ia) apply only to the amount which remained payable at the end of the relevant financial year and would not be invoked to disallow the amount which had actually been paid during the previous year without deduction of tax at source.

Departmental View: *The CBDT's view is that the provisions of section 40(a)(ia) would cover not only the amounts which are payable as on 31st March of a previous year but also amounts which are payable at any time during the year. The statutory provisions are amply clear and in the context of section 40(a)(ia), the term "payable" would include "amounts which are paid during the previous year".*

The Circular has further clarified that where any High Court decides an issue contrary to the above "Departmental View", the "Departmental View" shall not be operative in the area falling in the jurisdiction of the relevant High Court.

(3) any sum paid on account of tax or cess levied on profits on the basis of or in proportion to the profits and gains of any business or profession;

(a) Any sum paid outside India (on account of any rate or tax levied) which is eligible for tax relief under section 90 or deduction from the income-tax payable under section 91 is not allowable and is deemed to have never been allowable as a deduction under section 40(a).

(b) However, the tax payers will continue to be eligible for tax credit in respect of income-tax paid in a foreign country in accordance with the provisions of section 90 or section 91, as the case may be.

(c) Any sum paid outside India (on account of any rate or tax levied) and eligible for relief under section 90A will not be allowed as a deduction.

(4) any sum paid on account of wealth tax.

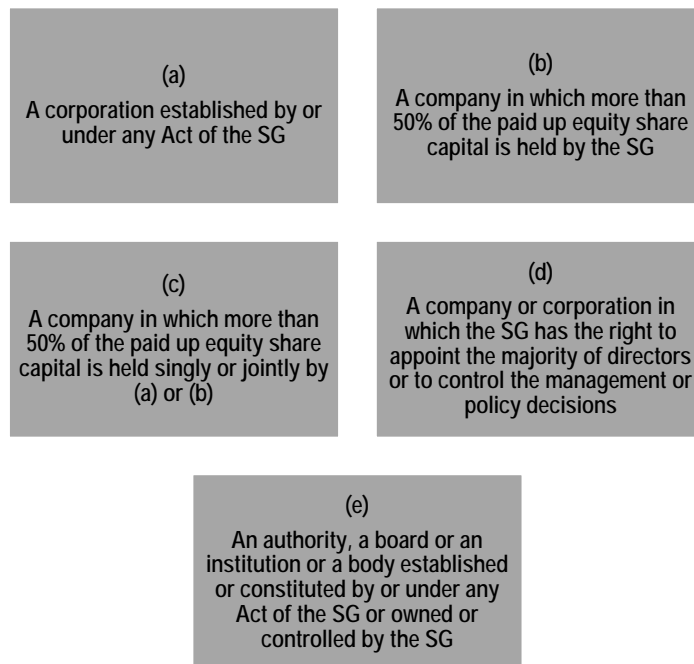
For the purpose of this disallowance the expression 'wealth-tax' means the wealth-tax chargeable under Wealth-tax Act, 1957, or any tax of similar nature or character chargeable under any law in any country outside India or any tax chargeable under such law with reference to the value of the assets of, or the capital employed in a business or profession carried on by the assessee, whether or not the debts of business or profession are allowed as a deduction in computing the amount with reference to which such tax is charged, but does

not include any tax chargeable with reference to the value of any particular asset of the business or profession.

(5) (i) any amount paid by way of royalty, licence fee, service fee, privilege fee, service charge, etc., which is levied exclusively on, or

(ii) any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government (SG)

A State Government undertaking includes –



(6) any sum which is chargeable under the head 'Salaries' if it is payable outside India or to a non-resident and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B.

(7) any contribution to a provident fund or the fund established for the benefit of employees of the assessee, unless the assessee has made effective arrangements to make sure that tax shall be deducted at source from any payments made from the fund which are chargeable to tax under the head 'Salaries'.

(8) Tax paid on perquisites on behalf of employees is not deductible- In case of an employee, deriving income in the nature of perquisites (other than monetary payments), the amount of tax on such income paid by his employer is exempt from tax in the hands of that employee. Correspondingly, such payment is not allowed as deduction from the income of the employer. Thus, the payment of tax on perquisites by an employer on behalf of employee will be exempt from tax in the hands of employee but will not be allowable as deduction in the hands of the employer.

(ii) **Section 40(b)** - In the case of any firm assessable as such or a limited liability partnership (LLP) the following amounts shall not be deducted in computing the income from business of any firm/LLP:

(1) Any salary, bonus, commission, remuneration by whatever name called, to any partner who is not a working partner. (In the following discussion, the term 'remuneration' is applied to denote payments in the nature of salary, bonus, commission);

(2) Any remuneration paid to the working partner or interest to any partner which is not authorised by or which is inconsistent with the terms of the partnership deed;

(3) It is possible that the current partnership deed may authorise payments of remuneration to any working partner or interest to any partner for a period which is prior to the date of the current partnership deed. The approval by the current partnership deed might have been necessitated due to the fact that such payment was not authorised by or was inconsistent with the earlier partnership deed. Such payments of remuneration or interest will also be disallowed. However, it should be noted that the current partnership deed cannot authorise any payment which relates to a period prior to the date of earlier partnership deed.

Next, by virtue of a further restriction contained in sub-clause (iii) of section 40(b), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not for any period prior thereto. Consequently, if, for instance, a firm incorporates the clause relating to payment of remuneration to the working partners, by executing an appropriate deed, say, on July 1, but effective from April 1, the firm would get deduction for the remuneration paid to its working partners from July 1 and onwards, but not for the period from April 1 to June 30. In other words, it will not be possible to give retrospective effect to oral agreements entered into vis a vis such remuneration prior to putting the same in a written partnership deed.

(4) Any interest payment authorised by the partnership deed falling after the date of such deed to the extent such interest exceeds 12% simple interest p.a.

(5) Any remuneration paid to a partner, authorised by a partnership deed and falling after the date of the deed in excess of the following limits:

On the first ₹ 3 lakh of book profit or in case of loss, the limit would be the higher of ₹ 1,50,000 or 90% of book profit and on the balance of book profit, the limit would be 60%.

Illustration 14

A firm has paid ₹ 7,50,000 as remuneration to its partners for the P.Y.2014-15, in accordance with its partnership deed, and it has a book profit of ₹ 10 lakh. What is the remuneration allowable as deduction?

Answer

The allowable remuneration calculated as per the limits specified in section 40(b)(v) would be –

Particulars	₹
On first ₹ 3 lakh of book profit [₹ 3,00,000 × 90%]	2,70,000

On balance ₹ 7 lakh of book profit [₹ 7,00,000 × 60%]	4,20,000
	6,90,000

The excess amount of ₹ 60,000 (i.e., ₹ 7,50,000 – ₹ 6,90,000) would be disallowed as per section 40(b)(v).

There are four Explanations to section 40(b):

Explanation 1 provides that where an individual is a partner in a firm in a representative capacity:

- (i) interest paid by the firm to such individual otherwise than as partner in a representative capacity shall not be taken into account for the purposes of this clause.
- (ii) interest paid by the firm to such individual as partner in a representative capacity and interest paid by the firm to the person so represented shall be taken into account for the purposes of this clause.

Explanation 2 provides that where an individual is a partner in a firm otherwise than in a representative capacity, interest paid to him by the firm shall not be taken into account if he receives the same on behalf of or for the benefit of any other person.

Explanation 3 defines the term “book profit”. It means the net profit as shown in the P & L A/c for the relevant previous year computed in accordance with the provisions for computing income from profits and gains.

The above amount should be increased by the remuneration paid or payable to all the partners of the firm if the same has been deducted while computing the net profit.

Explanation 4 defines a working partner. Accordingly, it means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner.

(iii) Section 40(ba) - Association of persons or body of individuals : Any payment of interest, salary, commission, bonus or remuneration made by an association of persons or body of individuals to its members will also not be allowed as a deduction in computing the income of the association or body.

There are three Explanations to section 40(ba):

Explanation 1 - Where interest is paid by an AOP or BOI to a member who has paid interest to the AOP/BOI, the amount of interest to be disallowed under clause (ba) shall be limited to the net amount of interest paid by AOP/BOI to the partner.

Explanation 2 - Where an individual is a member in an AOP/BOI on behalf of another person, interest paid by AOP/BOI shall not be taken into account for the purposes of clause (ba). But, interest paid to or received from each person in his representative capacity shall be taken into account.

Explanation 3 - Where an individual is a member in his individual capacity, interest paid to him in his representative capacity shall not be taken into account.

3.7 Expenses or payments not deductible in certain circumstances [Section 40A]

(i) **Payments to relatives and associates** - Sub-section (2) of section 40A provides that where the assessee incurs any expenditure in respect of which a payment has been or is to be made to a relative or to an associate concern so much of the expenditure as is considered to be excessive or unreasonable shall be disallowed by the Assessing Officer. While doing so he shall have due regard to :

- (a) the market value of the goods, service of facilities for which the payment is made; or
- (b) the legitimate needs of the business or profession carried on by the assessee; or
- (c) the benefit derived by or accruing to the assessee from such a payment.

The word "relative" as defined in the section 2(41) means, in relation to individual, the spouse, brother or sister of any lineal ascendant or descendant of that individual. Whether the assessee is a firm, H.U.F. or an association of persons the relationship will have to be reckoned for the purpose, with reference to the partners of the firm and the members of the family or association. Similarly, where the assessee is a company the relationship will have to be reckoned with reference to the directors or persons having substantial interest in the company.

The related person as mentioned in section 40A(2) includes, *inter alia*, a company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such director, partner or member. Further, the related person in relation to a company shall include any other company carrying on business or profession in which the first mentioned company has substantial interest.

A person shall be deemed to have a substantial interest in a business or profession if -

- in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of equity shares carrying not less than 20% of the voting power and
- in any other case such person is, at any time during the previous year, beneficially entitled to not less than 20% the profits of such business or profession.

(ii) **Cash payments in excess of ₹ 20,000** - According to section 40A(3), where the assessee incurs any expenditure, in respect of which payment or aggregate of payments made to a person in a day otherwise than by an account payee cheque drawn on a bank or by an account payee bank draft exceeds ₹ 20,000, such expenditure shall not be allowed as a deduction.

For example if, in respect of an expenditure of ₹ 60,000 incurred by X Ltd., 4 cash payments of ₹ 15,000 are made on a particular day to one Mr.Y – one in the morning at 10 a.m., one at 12 noon, one at 3 p.m. and one at 6 p.m., the entire expenditure of ₹ 60,000 would be

disallowed under section 40A(3), since the aggregate of cash payments made during a day to Mr.Y exceeds ₹ 20,000.

In case of an assessee following mercantile system of accounting, if an expenditure has been allowed as deduction in any previous year on due basis, and payment has been made in a subsequent year otherwise than by account payee cheque or account payee bank draft, then the payment so made shall be deemed to be the income of the subsequent year if such payment or aggregate of payments made to a person in a day exceeds ₹ 20,000 [Section 40A(3A)].

This limit of ₹ 20,000 has been raised to ₹ 35,000 in case of payment made to transport operators for plying, hiring or leasing goods carriages. Therefore, payment or aggregate of payments up to ₹ 35,000 in a day can be made to a transport operator otherwise than by way of account payee cheque or account payee bank draft. In all other cases, the limit would continue to be ₹ 20,000.

However, no disallowance would be made in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

The provision applies to all categories of expenditure involving payments for goods or services which are deductible in computing the taxable income. It does not apply to loan transactions because advancing of loans or repayments of the principal amount of loan does not constitute an expenditure deductible in computing the taxable income. However, interest payments of amounts exceeding ₹ 20,000 at a time are required to be made by account payee cheques or drafts as interest is a deductible expenditure. This requirement does not apply to payment made by commission agents for goods received by them for sale on commission or consignment basis because such a payment is not an expenditure deductible in computing the taxable income of the commission agent. For the same reason, this requirement does not apply to advance payment made by the commission agent to the party concerned against supply of goods. However, where commission agent purchases goods on his own account but not on commission basis, the requirement will apply. The provisions regarding payments by account payee cheque or draft apply equally to payments made for goods purchased on credit.

Rule 6DD provides for cases and circumstances in which a payment or aggregate of payments exceeding twenty thousand rupees may be made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft. As per this rule, no disallowance under sub-section (3) of section 40A shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3A) of section 40A where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees in the cases and circumstances specified hereunder, namely:

- (a) where the payment is made to
 - (i) the Reserve Bank of India or any banking company;

- (ii) the State Bank of India or any subsidiary bank;
- (iii) any co-operative bank or land mortgage bank;
- (iv) any primary agricultural credit society or any primary credit society;
- (v) the Life Insurance Corporation of India;
- (b) where the payment is made to the Government and, under the rules framed by it, such payment is required to be made in legal tender;
- (c) where the payment is made by
 - (i) any letter of credit arrangements through a bank;
 - (ii) a mail or telegraphic transfer through a bank;
 - (iii) a book adjustment from any account in a bank to any other account in that or any other bank;
 - (iv) a bill of exchange made payable only to a bank;
 - (v) the use of electronic clearing system through a bank account;
 - (vi) a credit card;
 - (vii) a debit card.
- (d) where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;
- (e) where the payment is made for the purchase of -
 - (i) agricultural or forest produce; or
 - (ii) the produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or
 - (iii) fish or fish products; or
 - (iv) the products of horticulture or apiculture,to the cultivator, grower or producer of such articles, produce or products;

Note -

- (i) The expression 'fish or fish products' (iii) above would include 'other marine products such as shrimp, prawn, cuttlefish, squid, crab, lobster etc.'
- (ii) The 'producers' of fish or fish products for the purpose of rule 6DD(e) would include, besides the fishermen, any headman of fishermen, who sorts the catch of fish brought by fishermen from the sea, at the sea shore itself and then sells the fish or fish products to traders, exporters etc.

However, the above exception will not be available on the payment for the purchase of fish or fish products from a person who is not proved to be a 'producer' of these goods and is only a trader, broker or any other middleman, by whatever name called.

- (f) where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;
 - (g) where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;
 - (h) where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;
 - (i) where the payment is made by an assessee by way of salary to his employee after deducting the income-tax from salary in accordance with the provisions of section 192 of the Act, and when such employee -
 - (i) is temporarily posted for a continuous period of fifteen days or more in a place other than his normal place of duty or on a ship; and
 - (ii) does not maintain any account in any bank at such place or ship;
 - (j) where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;
 - (k) where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;
 - (l) where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.
- (iii) Disallowance of provision for gratuity** - Section 40A(7) provides that no deduction would be allowable to any taxpayer carrying on any business or profession in respect of any provision (whether called as provision or by any other names) made by him towards the payment of gratuity to his employers on their retirement or on the termination of their employment for any reason. The reason for this disallowance is that, under section 36(1)(v), deduction is allowable in computing the profits and gains of the business or profession in respect of any sum paid by a taxpayer in his capacity as an employer in the form of contributions made by him to an approved gratuity fund created for the exclusive benefit of his employees under an irrevocable trust. Further, section 37(1) provides that any expenditure other than the expenditure of the nature described in sections 30 to 36 laid out or expended, wholly and exclusively for the purpose of the business or profession must be allowed as a deduction in computing the taxable income from business. A reading of these two provisions clearly indicates that the intention of the legislature has always been that the deduction in respect of gratuity be allowable to the employer either in the year in which the gratuity is actually paid or in the year in which contributions to an approved gratuity fund are actually made by employer. This provision, therefore, makes it clear that any amount claimed by the assessee towards provision for gratuity, by whatever name called would be disallowable in the assessment of employer even if the assessee follows the mercantile system of accounting.

However, no disallowance would be made under the provision of sub-section (7) of section 40A in the case where any provision is made by the employer for the purpose of payment of sum by way of contribution to an approved gratuity fund during the previous year or for the purpose of making payment of any gratuity that has become payable during the previous year by virtue of the employee's retirement, death, termination of service etc.

(iv) Contributions by employers to funds, trust etc. [Sections 40A(9) to (11)] - These sub-sections have been introduced to curb the growing practice amongst employers to claim deductions from taxable profits of the business of contributions made apparently to the welfare of employees from which, however, no genuine benefit flows to the employees.

Accordingly, no deduction will be allowed where the assessee pays in his capacity as an employer, any sum towards setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals, society registered under the Societies Registration Act, 1860 or other institution for any purpose. However, where such sum is paid in respect of funds covered by sections 36(1)(iv), 36(1)(iva) and 36(1)(v) or any other law, then the deduction will not be denied.

(v) Deduction in respect of Head Office expenses, in the case of non-residents - Section 44C restricts the scope of deduction available to non-resident taxpayers in the matter of allowance of head office expenses in computing their taxable income from the business carried on in India. These restrictions would have the effect of overriding anything to the contrary contained in the provisions for allowance of expenses and other deductions contained in sections 28 to 43A of the Income-tax Act, 1961. This provision prescribes the limits upto which the deduction could be allowed in computing profits and gains from any business carried on by the non-resident in India and apply to the expenses in the matter of head office expenses.

For the purpose of those restrictions and the consequent disallowance, the expression 'head office expenditure' must be taken to mean executive and general administration expenses incurred by the assessee outside India including also the expenditure incurred in respect of the following items viz.,

- (i) rent, rates, taxes, repairs or insurance in respect of any premises outside India used for the purpose of the business or profession;
- (ii) salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profit in lieu of or in addition to salary, whether paid or allowed to any employee or other persons employed in, or managing the affairs of any office in India;
- (iii) travelling expenses incurred in respect of any employee or other person who is employed in or who is looking after the management of the affairs of any office outside India; and
- (iv) such other matter connected with executive and general administration of the business as may be prescribed by the Central Board of Direct Taxes from time to time.

The limits prescribed are the following:

- (i) an amount equal to 5% of the adjusted total income of the assessee; or
- (ii) an amount of so much of the expenditure in the nature of head office expenses

(explained above), which are incurred by the assessee, as is attributable to the business or profession of the assessee in India.

The limit upto which the deduction is permissible to the assessee is the lesser of the aforesaid two amounts and consequently, the basis for allowance would be the lower of the above two items. If, however the actual amount on account of head office expenses claimed by the assessee is less than the limits specified above, the deduction admissible would be confined to the amount of actual expenditure incurred by the assessee.

For the purpose of determining the amount of deduction admissible to the assessee, the expression 'adjusted total income' used in item (i) above must be taken to mean the total income of the assessee computed in accordance with the provisions of the Income-tax Act before giving effect to the following items of allowance on deduction viz.,—

- (a) depreciation allowance under section 32(2);
- (b) capital expenditure on family planning incurred by companies admissible as a deduction under section 36(ix);
- (c) any brought-forward business loss qualifying for set off against business income in accordance with the provisions of section 72(1);
- (d) any brought-forward loss in regard to any speculation business qualifying for set off against income from speculation under section 73(3);
- (e) any loss computed under the head 'Capital gains' and brought forward from earlier assessment year qualifying for set-off under section 74(1); and
- (f) any loss attributable to the casual item of income assessable under section 56 qualifying for set-off in accordance with the provisions of section 74A(3).

Thus, the total income of the assessee computed for the relevant accounting year must be first ascertained before giving effect to the provisions for the aforesaid allowance and 5% thereof would be treated as the limit upto which head office expenses would be admissible as a deduction in computing the business income of the non-resident for income-tax purposes.

However, in cases where the adjusted total income of the assessee, 5% of which is to be taken as the basis for determining the first of the qualifying limits, happens to be a loss, the proviso to section 44C authorises the limit of 5% to be taken with reference to the average adjusted total income. For this purpose the expression 'average adjusted total income' would mean —

- (i) in cases where the total income of the assessee is assessable for each of the three assessment years immediately preceding the relevant assessment year - one-third of the aggregate amount of the adjusted total income of the previous years relevant to the aforesaid three assessment years.
- (ii) where the total income of the assessee is assessable for only two of the aforesaid three assessment years - one-half of the aggregate amount of the adjusted total income in respect of the two previous years relevant to the aforesaid two assessment years;
- (iii) in cases where the total income of the assessee becomes assessable only for one of the

three assessment years aforesaid - the amount of adjusted total incomes in respect of the previous year relevant to the assessment year.

The aforesaid provisions of restricting allowances on account of deduction in respect of head office expenditure would apply in the case of all non-resident taxpayers whose income from business or profession is chargeable to income-tax under section 28 of the Income-tax Act. The provisions for disallowance of the excess of the expenditure over the least of the limits mentioned above would apply even if the expenditure is such that it does not attract the provisions for disallowance contained in any other section of the Income-tax Act.

3.8 Profits chargeable to tax [Section 41]

This section enumerates certain receipts which are deemed to be income under the head "Business or profession." Such receipts would attract charge even if the business from which they arise had ceased to exist prior to the year in which the liability under this section arises. The particulars of such receipts are given below:

(i) **Section 41(1)** - Suppose an allowance or deduction has been made in any assessment year in respect of loss, expenditure or trading liability incurred by A. Subsequently, if A has obtained, whether in cash or in any manner whatsoever, any amount in respect of such loss or expenditure of some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by A, or the value of benefit accruing to him shall be taxed as income of that previous year. It does not matter whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not.

It is possible that after the above allowance in respect of loss, expenditure, or trading liability has been given to A, he could have been succeeded in his business by another person. In such a case, the successor will be liable to be taxed in respect of any such benefit received by him during a subsequent previous year.

Successor in business:

- (i) Where there has been an amalgamation of a company with another company, the successor will be the amalgamated company.
- (ii) Where a firm carrying on a business or profession is succeeded by another firm the successor will be the other firm.
- (iii) In any other case, where one person is succeeded by any other person in that business or profession the other person will be the successor.
- (iv) In case of a demerger, the successor will be the resulting company.

Remission or cessation of a trading liability includes remission or cessation of liability by a unilateral act of the assessee by way of writing off such liability in his accounts.

(ii) **Balancing charge, etc.** - The provisions of section 41(2) relating to balancing charge, of section 41(3) relating to assets acquired for scientific research and of section 41(4) dealing with recovery of bad debts have been dealt with earlier under the respective items.

(iii) **Section 41(4A)** - The withdrawal from special reserve created and maintained under section 36(1)(viii) will be deemed to be profits and gains of business and charged accordingly in the year of withdrawal. Even if the business is closed, it will be deemed to be in existence for this purpose. This also applies to section 41(5).

Brought forward losses of defunct business - In cases where a receipt is deemed under this section to be profit of a business under this section relating to a business that had ceased to exist and there is an unabsorbed loss, which arose in that business during the previous year in which it had ceased to exist, it would be set off against income that is chargeable under this section. This sub-section thus constitutes an exception to the rule that if a business has ceased to exist, any loss relating to it cannot be carried forward and set off against any income from any source.

3.9 Special provisions for deduction in case of business for prospecting etc. for mineral oil [Section 42]

This section has been enacted to permit an assessee to claim an allowance which may on general principles be inadmissible, e.g., allowance in respect of expenditure which would be regarded as an accretion to capital on the ground that it brings into existence an asset of enduring benefit or to constitute initial expenditure incurred on the setting up of a profit-earning machinery in motion. It must further be noted that this concession can be availed of only in relation to contract or arrangements entered into by the Central Government for prospecting for, or the extraction or production of mineral oils.

Allowable expenses : The allowance permissible under this section shall be in relation to (i) the expenditure by way of in fructuous or abortive exploration expenses in respect of an area surrendered prior to the beginning of commercial production by the assessee; (ii) after the beginning of commercial production, the expenditure incurred by the assessee, whether before or after such commercial production in respect of drilling or exploration activities in services in respect of physical assets used in that connection (except those assets which qualify for depreciation allowance under section 32); and (iii) to the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding years as may be specified in the agreement.

Amount of deduction: The sum of those allowance should be computed and deduction should be made in the manner specified in the agreement entered into by the Central Government with any person for the association or participation in the business of the Central Government for the prospecting or exploration of mineral oil. It has been specifically provided that the other provisions of the Act are being deemed, for the purpose of this allowance, to have been modified to the extent necessary to give effect to the terms of the agreement. It may be noted that allowances in this regard are made in lieu of or in addition to the other allowances permissible under the Act, depending upon the terms of the agreement.

Subject to the provisions of the agreement entered into by the Central Government, where the business of assessee consisting of the prospecting for or extraction or production of petroleum and natural gas is transferred or any interest therein is transferred, wholly or partly, in

accordance with the aforesaid agreement, various situations would arise. The tax treatment in respect of those situations are as follows:

(1) Where the proceeds of the transfer so far as they consist of capital sums are less than the expenditure incurred remaining unallowed, a deduction equal to such expenditure remaining unallowed, as reduced by the proceeds of transfer, shall be allowed in respect of the previous year in which such business or interest is transferred.

(2) Where such proceeds exceed the amount of the expenditure incurred remaining unallowed, so much of the excess as does not exceed the difference between the expenditure incurred in connection with the business or to obtain interest therein and the amount of such expenditure remaining unallowed, shall be chargeable to income-tax as profits and gains of the business in the previous year in which the business or interest therein, whether wholly or partly, had been transferred.

However, in a case where the provisions of this clause do not apply, the deduction to be allowed for expenditure incurred remaining unallowed shall be arrived at by subtracting the proceeds of transfer (so far as they consist of capital sums) from the expenditure remaining unallowed.

Explanation - Where the business or interest in such business is transferred in a previous year in which such business carried on by the assessee is no longer in existence, the provisions of this clause shall apply as if the business is in existence in that previous year.

(3) Where such proceeds are not less than the amount of the expenditure incurred remaining unallowed, no deduction for such expenditure shall be allowed in respect of the previous year in which the business or interest in such business is transferred or in respect of any subsequent year or years.

Special provisions in case of amalgamation/demerger: Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the business to the amalgamated company (being an Indian company), the provisions of this sub-section—

- (i) shall not apply in the case of the amalgamating company and
- (ii) shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamated company if the latter had not transferred the business or interest in the business.

The section provides for similar provisions in the case of demerger where the resulting company, being an Indian company, shall claim the production under the said section.

3.10 Changes in the rate of exchange of currency [Section 43A]

The section provides that where an assessee has acquired any asset from a foreign country for the purpose of his business or profession, and due to a change thereafter in the exchange rate of the two currencies involved, there is an increase or decrease in the liability (expressed in Indian rupees) of the assessee at the time of making the payment, the following values may be changed accordingly with respect to the increase or decrease in such liability:

- (i) the actual cost of the asset under section 43(1)

- (ii) the amount of capital expenditure incurred on scientific research under section 35(1)(iv)
- (iii) the amount of capital expenditure on acquisition of patents or copyrights under section 35A
- (iv) the amount of capital expenditure incurred by a company for promoting family planning amongst its employees under section 36(1)(ix)
- (v) the cost of acquisition of a non-depreciable capital asset falling under section 48.

The amount arrived at after making the above adjustment shall be taken as the amount of capital expenditure or the cost of acquisition of the capital asset, as the case may be.

The section further clarifies that where any adjustment has already been made under the erstwhile section 43A to the amount of capital expenditure or cost of acquisition of an asset on account of increase or decrease in liability due to exchange rate fluctuation, it should be verified that the amount of such adjustment is equal to the change in the liability at the time of making payment.

In this context

- (a) "rate of exchange" means the rate of exchange determined or recognised by the Central Government for the conversion of Indian currency into foreign currency or foreign currency into Indian currency;
- (b) "foreign currency" and "Indian currency" have the meanings respectively assigned to them in section 2 of the Foreign Exchange Management Act, 1999.

Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall not be taken into account for the purposes of this section.

Where the assessee has entered into a contract with a authorised dealer as defined in section 2 of the Foreign Exchange Management Act, 1999 for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, for adjustment under this section shall be computed with reference to the rate of exchange specified therein.

3.11 Certain Deductions to be Only on Actual Payment [Section 43B]

The following sums are allowed as deduction only on the basis of actual payment within the time limits specified in section 43B.

- (a) Any sum payable by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force.
- (b) Any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees.
- (c) Bonus or Commission for services rendered payable to employees.
- (d) Any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State Financial Corporation or a State Industrial Investment Corporation.

- (e) Interest on any loan or advance from a scheduled bank on actual payment basis.
- (f) Any sum paid by the assessee as an employer in lieu of earned leave of his employee.

The above sums can be paid by the assessee on or before the due date for furnishing the return of income under section 139(1) in respect of the previous year in which the liability to pay such sum was incurred and the evidence of such payment is furnished by the assessee along with such return.

For the purposes of clause (a), "any sum payable" means a sum for which the assessee incurred liability in the previous year even though such sum might not have been payable within that year under the relevant law. For example, an assessee may collect sales tax from customers during the month of March, 2014. However, in respect of such collections he may have to discharge the liability only within say 10th April, 2014 under the sales tax law. The explanation covers this type of liability also. Consequently, if an assessee following accrual method of accounting has created a provision in respect of such a liability the same is not deductible unless remitted within the due date specified in this section.

For this purpose, scheduled bank has the meaning assigned to it in clause (iii) of the *Explanation* to section 11(5), that is, the State Bank of India (SBI), a subsidiary of SBI, a nationalised bank or any other bank included in the Second Schedule to the Reserve Bank of India Act, 1934.

"State Industrial Investment Corporation" means a Government company within the meaning of section 617 of the Companies Act, 1956, engaged in providing long-term finance for industrial projects and eligible for deduction under section 36(1)(iii).

Explanation 3B provides that where a deduction in respect of earned leave encashment paid to any employee is allowed in computing the business income of the employer for the previous year in which the liability to pay was incurred (applicable for previous year 2000-2001 or any earlier year), no deduction shall be allowed in respect of such sum in the previous year in which the sum is actually paid.

Explanation 3C & 3D clarifies that if any sum payable by the assessee as interest on any such loan or borrowing or advance referred to in (d) and (e) above, is converted into a loan or borrowing or advance, the interest so converted and not "actually paid" shall not be deemed as actual payment, and hence would not be allowed as deduction. The clarificatory explanations only reiterate the rationale that conversion of interest into a loan or borrowing or advance does not amount to actual payment.

The manner in which the converted interest will be allowed as deduction has been clarified in *Circular No. 7/2006 dated 17.7.2006*. The unpaid interest, whenever actually paid to the bank or financial institution, will be in the nature of revenue expenditure deserving deduction in the computation of income. Therefore, irrespective of the nomenclature, the deduction will be allowed in the previous year in which the converted interest is actually paid.

Illustration 15

Hari, an individual, carried on the business of purchase and sale of agricultural commodities

like paddy, wheat, etc. He borrowed loans from Andhra Pradesh State Financial Corporation and Indian Bank and has not paid interest as detailed hereunder:

		₹
(i)	Andhra Pradesh State Financial Corporation (P.Y. 2013-14 & 2014-15)	15,00,000
(ii)	Indian Bank (P.Y. 2014-15)	<u>30,00,000</u>
		<u>45,00,000</u>

Both Andhra Pradesh State Financial Corporation and Indian Bank, while restructuring the loan facilities of Hari during the year 2014-15, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2015, Hari paid 5 installments to Andhra Pradesh State Financial Corporation and 3 installments to Indian Bank.

Hari claimed the entire interest of ₹ 45,00,000 as an expenditure while computing the income from business of purchase and sale of agricultural commodities. Discuss whether his claim is valid and if not what is the amount of interest, if any, allowable.

Solution

According to section 43B, any interest payable on the term loans to specified financial institutions and any interest payable on any loans and advances to scheduled banks shall be allowed only in the year of payment of such interest irrespective of the method of accounting followed by the assessee. Where there is default in the payment of interest by the assessee, such unpaid interest may be converted into loan. Such conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest so converted as loan shall be allowed as deduction only in the year in which the converted loan is actually paid.

In the given case of Hari, the unpaid interest of ₹ 15,00,000 due to Andhra Pradesh State Financial Corporation (APSFC) and of ₹ 30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of ₹ 45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y.2015-16 shall be calculated as follows:

	Interest outstanding	Number of Installments	Amount per installment	Installments paid	Interest allowable (₹)
APSFC	15 lakh	60	25,000	5	1,25,000
Indian Bank	30 lakh	60	50,000	3	1,50,000
Total amount eligible for deduction					2,75,000

3.12 Special Provision for Computation of Cost of Acquisition of Certain Assets [Section 43C]

(i) Where an asset acquired under a scheme of amalgamation is sold by an amalgamated company as its stock-in-trade then in computing the profits and gains derived from sale of such stock-in-trade the cost of acquisition of stock-in-trade to the amalgamated company shall be the cost of acquisition of such stock-in-trade or the asset to the amalgamating company as increased by the cost if any of any improvement thereto and the expenditure incurred wholly and exclusively in connection with such a transfer.

(ii) The provisions of section 43C will thus apply to the following cases of revaluation:

(a) When the stock-in-trade of the amalgamating company is taken over at reduced price by the amalgamated company under the scheme of amalgamation.

(b) Where a capital asset of the amalgamating company is taken over as stock-in-trade by the amalgamated company after revaluation under the scheme of amalgamation.

(iii) The situation referred to at (b) above will in turn cover three situations:

(1) When the capital asset is converted to stock-in-trade by the amalgamating company with revaluation and the revalued asset is taken over by the amalgamated company under the scheme of amalgamation.

(2) Where the capital asset is taken over as stock-in-trade by the amalgamated company at renewed price at the time of amalgamation.

(3) Where the capital asset of the amalgamating company is taken over by the amalgamated company as a capital asset and has been converted into stock-in-trade and revalued.

(iv) In a case referred to above, where the revaluation and conversion of capital asset into stock-in-trade takes place in the hands of the amalgamated company the provisions of section 45(2) will apply. So in such a case the provision of section 43C will not apply. This has been done with a view to ensure that a tax payer does not face double taxation in respect of the same transaction. However when the stock-in-trade referred to in item (i) as well as at (a) and (b) above are sold, the provisions of section 43C will apply.

(v) A similar provision in section 43C has also been made to cover cases where the asset sold as stock-in-trade has been acquired by the assessee either by way of full or partial partition of HUF or under a gift or will or an irrevocable trust and such asset is sold as stock-in-trade.

3.13 Stamp Duty Value of land and building to be taken as the full value of consideration in respect of transfer, even if the same are held by the transferor as stock-in-trade [Section 43CA]

(i) At present, the provisions of section 50C require adoption of stamp duty value of land or building or both, which are held as a capital asset, if the same are transferred for a consideration which is less than the value adopted, assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer.

(ii) However, such provisions are not applicable in case of transfer of immovable property, held by the transferor as stock-in-trade.

(iii) Therefore, as an anti-avoidance measure, new section 43CA has been inserted to provide that where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable (i.e., the stamp duty value) shall be deemed to be the full value of the consideration for the purposes of computing income under the head "Profits and gains of business of profession".

(iv) Further, where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer instead of on the date of registration for such transfer, provided at least a part of the consideration has been received by any mode other than cash on or before the date of the agreement.

(v) The Assessing Officer may refer the valuation of the asset to a valuation officer as defined in section 2(r) of the Wealth-tax Act, 1957 in the following cases -

(1) Where the assessee claims before any Assessing Officer that the value adopted or assessed or assessable by the authority for payment of stamp duty exceeds the fair market value of the property as on the date of transfer and

(2) the value so adopted or assessed or assessable by such authority has not been disputed in any appeal or revision or no reference has been made before any other authority, court or High Court.

(vi) Where the value ascertained by the Valuation Officer exceeds the value adopted or assessed or assessable by the Stamp Valuation Authority, the value adopted or assessed or assessable shall be taken as the full value of the consideration received or accruing as a result of the transfer.

The term "assessable" covers transfers executed through power of attorney. The term 'assessable' has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in

force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

Example

Case	Date of transfer of land / building held as stock-in-trade	Actual consideration	Stamp duty value on the date of agreement	Stamp duty value on the date of registration	Full value of consideration	Remark
		₹ in lakhs				
1	1/5/2014	100 (₹10 lakhs received by cheque on 31/8/2013)	120 (1/9/2013)	210 (1/5/2014)	120	Stamp duty value on the date of agreement to be adopted as full value of consideration.
2	1/5/2014	100 (₹10 lakhs received by cash on 31/8/2013)	120 (1/9/2013)	210 (1/5/2014)	210	Stamp duty value on the date of registration to be adopted as full value of consideration.
3	31/3/2015	100 (Full amount received on the date of registration)	120 (1/5/2014)	210 (31/3/2015)	210	Stamp duty value of the date of registration would be the full value of consideration.

3.14 Special Provision in case of income of Public Financial Institutions [Section 43D]

(i) In the case of a public financial institution or a scheduled bank or a State financial corporation or a State industrial investment corporation, the income by way of interest on such categories of bad and doubtful debts, as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said institutions for that year or in the previous year in which it is actually received by them, whichever is earlier. This provision is now applicable to co-operative banks also [Sub-clause (a)].

(ii) In the case of a public company, the income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the National Housing Bank established under the National Housing Bank Act, 1987 in relation to such debts shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said public company for that year or in the previous in which it is actually received by it, whichever is earlier. [Sub-clause (b)].

3.15 Insurance Business [Section 44]

The profits and gains of any business of insurance, including any such business carried on by a mutual insurance company or by a co-operative society, shall be computed in accordance with the rules contained in the First Schedule of the Income-tax Act, 1961. This is notwithstanding anything to the contrary contained in the provisions of the Income-tax Act, 1961 relating to computation of income chargeable under the head "Income from house property", "Capital gains" or "Income from other sources" or in section 199 or in sections 28 to 43B.

3.16 Special provisions in the case of certain associations [Section 44A]

This is a provision calculated to encourage the development activities carried on by the trade, professional and other associations other than those whose incomes are already exempted under section 10(23A). This section provides that where the expenditure incurred by an association solely for purposes of protection or advancement of the common interest of its members exceeds the amount collected by the association from the members whether by way of subscription or otherwise, the resulting deficiency shall be allowed as a deduction in computing the income of the association assessable under the head "profits and gains of business or profession"; if there is no such income, then, it will be allowed as a deduction in computing the income under any other head. However, only an amount up to 50% of total taxable income of the association can be set off against the deficiency aforementioned. In computing the taxable income of the association, effect must first be given to the allowances or losses brought forward under any other section of the Act. This section applies only to such associations which do not distribute their income amongst their members except in the form of grants to affiliated associations.

3.17 Compulsory maintenance of accounts [Section 44AA]

This section provides that every person carrying on the legal, medical, engineering or architectural profession or accountancy or technical consultancy or interior decoration or any other profession as has been notified by the Central Board of Direct Taxes in the Official Gazette must statutorily maintain such books of accounts and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act. The persons carrying on these professions are statutorily obliged to maintain the prescribed books of account and other documents regardless of the quantum of their income and also regardless of the question whether the profession was set up prior to or after the coming into force of this new provision.

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The professions notified so far are as the profession of authorised representative; the profession of film artiste (actor, camera man, director, music director, art director, editor, singer, lyricist, story writer, screen play writer, dialogue writer and dress designer); the profession of Company Secretary; and information technology professionals.

Every taxpayer carrying on any business or profession (other than the professions specified above) must maintain the books of account prescribed by the Central Board of Direct Taxes in the following circumstances:

- (a) in cases where the income from the business or profession exceeds ₹ 1,20,000 or the total sales turnover or gross receipts, as the case may be, in the business or profession exceed ₹ 10,00,000 in any one of three years immediately preceding the accounting year; or
- (b) in cases where the business or profession is newly set up in any previous year, if his income from business or profession is likely to exceed ₹ 1,20,000 or his total sales turnover or gross receipts, as the case may be, in the business or profession are likely to exceed ₹ 10,00,000 during the previous year ;
- (c) in cases where profits and gains from the business are calculated on a presumptive basis under section 44AE or 44BB or 44BBB and the assessee has claimed that his income is lower than the profits or gains so deemed to be the profits and gains of his business.
- (d) in cases where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the basic exemption limit during such previous year.

In such cases, compulsory tax audit would also become necessary.

The Central Board of Direct Taxes has been authorised, having due regard to the nature of the business or profession carried on by any class of persons, to prescribe by rules the books of account and other documents including inventories, wherever necessary, to be kept and maintained by the taxpayer, the particulars to be contained therein and the form and manner in which and the place at which they must be kept and maintained. Further, the Central Board of Direct Taxes has also been empowered to prescribe, by rules, the period for which the books of account and other documents are required to be kept and maintained by the taxpayer.

Rule 6F of the Income-tax Rules contains the details relating to the books of account and other documents to be maintained by certain professionals under section 44A.

As per Rule 6F, every person carrying on legal, medical, engineering, or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorised representative or film artist shall keep and maintain the books of account and other documents specified in sub-rule (2) in the following cases :

- if his gross receipts exceed ₹ 1,50,000 in all the 3 years immediately preceding the previous year ; or
- if, where the profession has been newly set up in the previous year, his gross receipts are likely to exceed ₹ 1,50,000 in that year.

Note : Students may note that professionals whose gross receipts are less than the specified limits given above are also required to maintain books of account but these have not been specified in the Rule. In other words, they are required to maintain such books of account and other documents as may enable the Assessing Officer to compute the total income in accordance with the provisions of this Act.

Sub-rule (2) of Rule 6F: The following books of account and other documents are required to be maintained.

- (i) a cash book;
- (ii) a journal, if accounts are maintained on mercantile basis ;
- (iii) a ledger;
- (iv) Carbon copies of bills and receipts issued by the person whether machine numbered or otherwise serially numbered, in relation to sums exceeding ₹ 25;
- (v) Original bills and receipts issued to the person in respect of expenditure incurred by the person, or where such bills and receipts are not issued, payment vouchers prepared and signed by the person, provided the amount does not exceed ₹ 50. Where the cash book contains adequate particulars, the preparation and signing of payment vouchers is not required.

In case of a person carrying on medical profession, he will be required to maintain the following in addition to the list given above:

- (i) a daily case register in Form 3C.
- (ii) an inventory under broad heads of the stock of drugs, medicines and other consumable accessories as on the first and last day of the previous year used for his profession.

The above books of account and documents shall be kept and maintained for a minimum of 6 years from the end of the relevant assessment year. However, where the assessment in relation to any assessment year has been reopened under section 147 within the period specified in section 149, all the books of account and other documents which were kept and maintained at the time of reopening the assessment shall continue to be so kept and maintained till the assessment so reopened has been completed.

The books and documents shall be kept and maintained at the place where the person is carrying on the profession, or where there is more than one place, at the principal place of his profession. However, if he maintains separate set of books for each place of his profession, such books and documents may be kept and maintained at the respective places.

3.18 Audit of accounts of certain persons carrying on business or profession [Section 44AB]

- (i) It is obligatory in the following cases for a person carrying on business or profession to get his accounts audited before the "specified date" by a Chartered Accountant:
 - (1) if the total sales, turnover or gross receipts in business exceeds ₹ 100 lakh in any previous year; or

- (2) if the gross receipts in profession exceeds ₹ 25 lakh in any previous year; or
 - (3) where the assessee is covered under section 44AE, 44BB or 44BBB and claims that the profits and gains from business are lower than the profits and gains computed on a presumptive basis. In such cases, the normal monetary limits for tax audit in respect of business would not apply.
 - (4) where the assessee is covered under section 44AD, and he claims that the profits and gains from business are lower than the profits and gains computed on a presumptive basis and his income exceeds the basic exemption limit.
- (ii) The person mentioned above would have to furnish by the specified date a report of the audit in the prescribed forms. For this purpose, the Board has prescribed under Rule 6G, Forms 3CA/3CB/3CD containing forms of audit report and particulars to be furnished therewith.
- (iii) In cases where the accounts of a person are required to be audited by or under any other law before the specified date, it will be sufficient if the person gets his accounts audited under such other law before the specified date and also furnish by the said date the report of audit in the prescribed form in addition to the report of audit required under such other law. Thus, for example, the provision regarding compulsory audit does not imply a second or separate audit of accounts of companies whose accounts are already required to be audited under the Companies Act, 1956. The provision only requires that companies should get their accounts audited under the Companies Act, 1956 before the specified date and in addition to the report required to be given by the auditor under the Companies Act, 1956 furnish a report for tax purposes in the form to be prescribed in this behalf by the CBDT.
- (iv) However, the requirement of audit under section 44AB does not apply to a person who derives income of the nature referred to in sections 44B and 44BBA.
- (v) The expression "specified date" in relation to the accounts of the previous year or years relevant to any assessment year means the due date for furnishing the return of income under section 139(1). For due date of furnishing return of income, refer section 139(1) in Chapter 10 "Provisions for filing return of income".
- (vi) It may be noted that under section 271B, penal action can be taken for not getting the accounts audited and for not filing the audit report by the specified date.

Note - The Institute has brought out a Guidance Note dealing with the various aspects of tax audit under section 44AB. Students are advised to read the same carefully.

3.19 Special provisions for computing profits and gains of business on presumptive basis [Section 44AD]

- (i) The presumptive taxation scheme under section 44AD covers all small businesses with total turnover/gross receipts of up to ₹ 100 lakh (except the business of plying, hiring and leasing goods carriages covered under section 44AE).
- (ii) Resident individuals, HUFs and partnership firms (but not LLPs) would be covered under this scheme.

- (iii) The scheme would not apply to an assessee who is availing deductions under section 10AA or deduction under any provisions of Chapter VIA under the heading "C.—Deductions in respect of certain incomes" in the relevant assessment year.
- (iv) The presumptive rate of tax would be 8% of total turnover or gross receipts. However, the assessee has the option to declare in his return of income, an amount higher than the presumptive income so calculated, claimed to have been actually earned by him.
- (v) All deductions allowable under sections 30 to 38 shall be deemed to have been allowed in full and no further deduction shall be allowed. However, in the case of a firm, salary and interest would be allowed as deduction subject to the conditions and limits prescribed under section 40(b).
- (vi) The written down value of any asset of such business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of depreciation for each of the relevant assessment years.
- (vii) The intention of widening the scope of this scheme is to reduce the compliance and administrative burden on small businessmen and relieve them from the requirement of maintaining books of account. Such assessee opting for the presumptive scheme are not required to maintain books of account under section 44AA or get them audited under section 44AB.
- (viii) Further, they would also be relieved from the requirement of advance tax payments. It would be sufficient compliance if they pay their tax while filing their return of income before the due date.
- (ix) An assessee with turnover of upto ₹ 100 lakh, who shows an income below the presumptive rate prescribed under these provisions, will, in case his total income exceeds the taxable limit, be required to maintain books of accounts under section 44AA and also get them audited under section 44AB.

Thus, merely because an eligible assessee does not opt for presumptive taxation under section 44AD, it would not make him liable to maintain books of account under section 44AA or get the same audited under section 44AB. He will have to comply with these requirements only if his total income exceeds the taxable limit. If his total income does not exceed the taxable limit, the requirement of maintaining books of accounts under section 44AA and having the same audited under section 44AB would not arise.

- (x) The following persons are specifically excluded from the applicability of the presumptive provisions of section 44AD -
 - (a) a person carrying on profession as referred to in section 44AA(1) i.e., legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board (namely, authorized representatives, film artists, company secretaries and profession of information technology have been notified by the Board for this purpose);

- (b) a person earning income in the nature of commission or brokerage; or
- (c) a person carrying on any agency business.

3.20 Special provisions for computing profits and gains of business of plying, hiring or leasing goods carriages [Section 44AE]

- (i) This section provides for estimating business income of an owner of goods carriages from the plying, hire or leasing of such goods carriages;
- (ii) The scheme applies to persons owning not more than 10 goods vehicles at any time during the previous year;
- (iii) *The estimated income from each goods vehicle, whether heavy goods vehicle or other than heavy goods vehicle, will be deemed to be ₹ 7,500 for every month or part of a month during which such vehicle is owned by the assessee for the previous year. The assessee can also declare a higher amount in his return of income. In such case, the latter will be considered to be his income;*
- (iv) The assessee will be deemed to have been allowed the deductions under sections 30 to 38. Accordingly, the written down value of any asset used for the purpose of the business of the assessee will be deemed to have been calculated as if the assessee had claimed and had actually been allowed the deduction in respect of depreciation for each of the relevant assessment years.
- (v) The assessee joining the scheme will not be required to maintain books of account under section 44AA and get the accounts audited under section 44AB in respect of such income.

An assessee may claim lower profits and gains than the deemed profits and gains specified in sub-section (1) of that section subject to the condition that the books of account and other documents are kept and maintained as required under sub-section (2) of section 44AA and the assessee gets his accounts audited and furnishes a report of such audit as required under section 44AB.

Illustration 16

An assessee owns a light commercial vehicle for 9 months 15 days, a medium goods vehicle for 9 months and a medium goods vehicle for 12 months during the previous year. Compute his income applying the provisions of section 44AE.

Solution

His profits and gains from the 3 trucks shall be deemed to be ₹ 7,500 × 10 + ₹ 7,500 × 9 + ₹ 7,500 × 12 = ₹ 2,32,500.

Illustration 17

Mr. X commenced the business of operating goods vehicles on 1.4.2014. He purchased the following vehicles during the P.Y.2014-15. Compute his income under section 44AE for A.Y.2015-16.

	Type of Vehicle	Number	Date of purchase
(1)	Light Goods Vehicles	2	10.4.2014
		1	15.3.2015
(2)	Medium Goods Vehicles	3	16.7.2014
		1	2.1.2015
(3)	Heavy Goods Vehicles	2	29.8.2014
		1	23.2.2015

Would your answer change if the two light goods vehicles purchased in April, 2014 were put to use only in July, 2014?

Solution

Since Mr. X does not own more than 10 vehicles at any time during the previous year 2014-15, he is eligible to opt for presumptive taxation scheme under section 44AE. ₹ 7,500 per month or part of month for which each goods carriage is owned by him would be deemed as his profits and gains from such goods carriage.

(1)	(2)	(3)	(4)
Number of Vehicles	Date of purchase	No. of months for which vehicle is owned	No. of months × No. of vehicles [(1) × (3)]
2	10.4.2014	12	24
1	15.3.2015	1	1
3	16.7.2014	9	27
1	2.1.2015	3	3
2	29.8.2014	8	16
1	23.2.2015	2	2
10	Total		73

Therefore, presumptive income of Mr. X under section 44AE for A.Y.2015-16 is ₹ 5,47,500, being $73 \times ₹ 7,500$.

The answer would remain the same even if the two vehicles purchased in April, 2014 were put to use only in July, 2014, since the presumptive income of ₹ 7,500 per month has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.

3.21 Special provision for computing the profits and gains of shipping business in case of non-residents [Section 44B]

(i) This section provides for computation of the profits and gains of the business of shipping carried on by non-residents to the extent they are chargeable to income-tax in India. According to this, a sum equal to 7½% of the aggregate of the following amounts must be deemed to be the profits and gains of the business of shipping chargeable to tax under the head 'profits and gains of business or profession'.

(ii) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India.

(iii) The amount received or deemed to be received in India by the assessee himself or by any other person on behalf of or on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

The total of the above two amounts must be ascertained and 7½% thereof would be calculated and taken as the income from the business chargeable to tax in India. These provisions for computation of the income from the shipping business in case of non-residents would apply notwithstanding anything to the contrary contained in the provisions of sections 28 to 43A of the Income-tax Act, 1961. In other words, the income would be computed on this basis without applying the various provisions contained in sections 28 to 43A. Consequential provisions are also seen in section 172.

For the purposes of sub-section (2), receipts forming the basis of estimates on non resident shipping lines will include demurrage and handling charges.

3.22 Provisions for computation of taxable income from activities connected with exploration of mineral oils [Section 44BB]

(i) The computation of taxable income of non-resident taxpayer engaged in the business of providing services and facilities in connection with or supplying plant and machinery on hire, used or to be used in the exploration for, and exploitation of mineral oils involves a number of complications.

(ii) As a measure of simplification, section 44BB provides for determination of income of such taxpayer at 10% of the aggregate of certain amounts. The amounts in respect of which the provisions will apply would be the amounts paid or payable to the taxpayer or to any person on his behalf whether in or out of India, on account of the provision of such services or facilities or supplying plant and machinery for the aforesaid purposes. This amount will also include facilities or supply of plant and machinery. This provision will not, however apply to any income to which the provisions of section 42, 44D, 44DA, 115A or 293A apply. It may be noted that section 44BB applies only to non-resident assesseees.

(iii) Such taxpayers may claim lower income than the present presumptive rate of 10%, if they keep and maintain books of accounts and documents as required under sub-section (2) of section 44AA and get their accounts audited under the provisions of section 44AB of the Act. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

Note - If the income of a non-resident is in the nature of fees for technical services, it shall be taxable under the provisions of either section 44DA or section 115A irrespective of the business to which it relates. Section 44BB would apply only in a case where consideration is for services and other facilities relating to exploration activity which are not in the nature of technical services.

3.23 Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents [Section 44BBA]

Under section 44BBA(1), a sum equal to 5% of the aggregate of the amounts specified in sub-section (2) is deemed to be the profits and gains chargeable to tax under the head "Profits and gains of business or profession". Sub-section (2) specifies the following amounts -

- (a) the amount paid or payable, whether in or out of India, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and
- (b) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

Illustration 18

Mr. Tiwari, a non-resident, operates an aircraft between Bangkok and Mumbai. He received the following amounts in the course of the business of operation of aircraft during the year ending 31.3.2015:

- (i) ₹ 3 crore in India on account of carriage of passengers from Mumbai.
- (ii) ₹ 2 crore in India on account of carriage of goods from Mumbai.
- (iii) ₹ 1 crore in India on account of carriage of passengers from Bangkok.
- (iv) ₹ 2 crore in Bangkok on account of carriage of passengers from Mumbai.

The total expenditure incurred by Mr. Tiwari for the purposes of the business during the year ending 31.3.2015 was ₹ 1.8 crore.

Compute the income of Mr. Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2015-16.

Solution

Keeping in view the provisions of section 44BBA, the income of Mr. Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" is worked out hereunder -

	₹
Amount received in India on account of carriage of passengers from Mumbai	3,00,00,000
Amount received in India on account of carriage of goods from Mumbai	2,00,00,000

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Amount received in India on account of carriage of passengers from Bangkok	1,00,00,000
Amount received in Bangkok on account of carriage of passengers from Mumbai	2,00,00,000
	8,00,00,000

Income from business under section 44BBA at 5% of ₹ 8,00,00,000 is ₹ 40,00,000, which is the income of Mr. Tiwari chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2015-16.

3.24 Special provision for computing profits and gains of foreign companies engaged in the business of civil construction etc. in certain turnkey power projects [Section 44BBB]

(i) Under this provision in the case of a foreign company engaged in the business of construction or the business of erection of plant or machinery or testing or commissioning thereof in connection with a turnkey power project approved by the Central Government in this behalf, a sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head 'profits and gains of business or profession'.

(ii) However, such taxpayers may claim lower income than the present presumptive rate of 10%, if they keep and maintain books of accounts and documents as required under section 44AA(2) and get their accounts audited under the provisions of section 44AB. The assessment in all such cases shall be done by the Assessing Officer under section 143(3).

3.25 Special provisions for computing income by way of royalties etc. in case of non-residents [Section 44DA]

(i) The income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by a non-corporate non-resident or a foreign company with Government or the Indian concern after the 31st March, 2003 in respect of such non-corporate non-resident or a foreign company which carries on business in India, shall be computed on the basis of books of accounts required to be maintained under the Act.

(ii) Such business should be carried on through a permanent establishment, or the assessee should perform professional services from a fixed place of profession in India

(iii) They should keep and maintain books of account and other documents in accordance with the provisions contained in section 44AA.

(iv) They should get their accounts audited by an accountant as defined in the *Explanation* below section 288(2) and furnish along with the return of income, the report of such audit in the prescribed form duly signed and verified by such accountant.

(v) No deduction will be allowed while computing income of such non-resident, of the expenditure which is not wholly and exclusively incurred for the business of such permanent establishment or fixed place and also of any amount paid by the permanent establishment to its head office or any of its offices.

(vi) There have been legal decisions which have expressed contradictory views regarding the scope and applicability of section 44BB vis-à-vis section 44DA on the issue of taxability of fee for technical services relating to the exploration sector.

(vii) In order to reflect the correct legislative intention regarding taxation of income by way of fee for technical services, section 44BB has been amended to exclude the applicability of section 44BB to the income which is covered under section 44DA. A similar amendment has been made in section 44DA to provide that provisions of section 44BB would not be applicable in respect of the income covered under section 44DA.

(viii) Therefore, if the income of a non-resident is in the nature of fees for technical services, it shall be taxable under the provisions of either section 44DA or section 115A irrespective of the business to which it relates. Section 44BB would apply only in a case where consideration is for services and other facilities relating to exploration activity which are not in the nature of technical services.

3.26 Method of computing deduction in the case of business reorganisation of co-operative banks [Section 44DB]

- (i) This section provides the manner in which the deduction under the following sections are to be allowed in a case where business reorganisation of a co-operative bank has taken place during the financial year –
 - (1) Section 32 (Depreciation);
 - (2) Section 35D (Amortisation of certain preliminary expenses);
 - (3) Section 35DD (Amortisation of expenses in case of amalgamation or demerger);
 - (4) Section 35DDA (Amortisation of expenditure incurred under voluntary retirement scheme).
- (ii) Business reorganisation means the reorganisation of business involving the amalgamation or demerger of a co-operative bank.
- (iii) Co-operative bank shall have the meaning assigned to it in clause (cci) of section 5 of the Banking Regulation Act, 1949 i.e., a primary co-operative bank or Central Co-operative bank or a State co-operative bank.
- (iv) Predecessor co-operative bank means the amalgamating co-operative bank or the demerged co-operative bank, as the case may be.
- (v) Successor co-operative bank means the amalgamated co-operative bank or the resulting bank, as the case may be.

- (vi) The amount of deduction allowable to the predecessor co-operative bank under the above-mentioned sections has to be determined in accordance with the following formula-

$$A \times \frac{B}{C}$$

A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the 1st day of the financial year and ending on the day immediately preceding the date of business reorganisation; and

C = the total number of days in the financial year in which the business reorganisation has taken place.

- (vii) The amount of deduction allowable to the successor co-operative bank under the above-mentioned sections has to be determined in accordance with the formula -

$$A \times \frac{B}{C}$$

A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganisation had not taken place;

B = the number of days comprised in the period beginning with the date of business reorganisation and ending on the last day of the financial year; and

C = the total number of days in the financial year in which the business reorganisation has taken place.

For example, let us take a case where the deduction allowable under section 32 to the predecessor co-operative bank is, say, ₹ 1,20,000 and the business re-organisation took place on 1.11.2014. Then, the deduction allowable to the predecessor co-operative bank under section 32 would be ₹ 70,356 i.e., ₹ 1,20,000 x 214/365. The deduction allowable to the successor co-operative bank would be ₹ 49,644 i.e., ₹ 1,20,000 x 151/365.

- (viii) In a case where an undertaking of the predecessor co-operative bank entitled to the deduction under sections 35D, 35DD or 35DDA is transferred before the expiry of the period specified therein to a successor co-operative bank on account of business reorganisation, the provisions of section 35D, section 35DD or section 35DDA shall apply to the successor co-operative bank in the financial years subsequent to the year of business reorganisation as they would have applied to the predecessor co-operative bank, as if the business reorganisation had not taken place.
- (ix) Amalgamated co-operative bank means -

- (1) a co-operative bank with which one or more amalgamating co-operative banks merge; or
- (2) a co-operative bank formed as a result of merger of two or more amalgamating co-operative banks.
- (x) Amalgamating co-operative bank means -
 - (1) a co-operative bank which merges with another co-operative bank; or
 - (2) every co-operative bank merging to form a new co-operative bank.
- (xi) Amalgamation means the merger of an amalgamating co-operative bank or banks with an amalgamated co-operative bank, in such a manner that -
 - (1) all the assets and liabilities of the amalgamating co-operative bank or banks immediately before the merger (other than the assets transferred, by sale or distribution on winding up, to the amalgamated co-operative bank) become the assets and liabilities of the amalgamated co-operative bank;
 - (2) the members holding 75% or more voting rights in the amalgamating co-operative bank become members of the amalgamated co-operative bank; and
 - (3) the shareholders holding 75% or more in value of the shares in the amalgamating co-operative bank (other than the shares held by the amalgamated co-operative bank or its nominee or its subsidiary, immediately before the merger) become shareholders of the amalgamated co-operative bank.
- (xii) Demerger means the transfer by a demerged co-operative bank of one or more of its undertakings to any resulting co-operative bank, in such manner that -
 - (1) all the assets and liabilities of the undertaking or undertakings immediately before the transfer become the assets and liabilities of the resulting co-operative bank;
 - (2) the assets and the liabilities are transferred to the resulting co-operative bank at values (other than change in the value of assets consequent to their revaluation) appearing in its books of account immediately before the transfer;
 - (3) the resulting co-operative bank issues, in consideration of the transfer, its membership to the members of the demerged co-operative bank on a proportionate basis;
 - (4) the shareholders holding 75% or more in value of the shares in the demerged co-operative bank (other than shares already held by the resulting bank or its nominee or its subsidiary immediately before the transfer), become shareholders of the resulting co-operative bank, otherwise than as a result of the acquisition of the assets of the demerged co-operative bank or any undertaking thereof by the resulting co-operative bank;
 - (5) the transfer of the undertaking is on a going concern basis; and

- (6) the transfer is in accordance with the conditions specified by the Central Government, by notification in the Official Gazette, having regard to the necessity to ensure that the transfer is for genuine business purposes.
- (xiii) Demerged co-operative bank means the co-operative bank whose undertaking is transferred, pursuant to a demerger, to a resulting bank.
- (xiv) Resulting co-operative bank means -
- (1) one or more co-operative banks to which the undertaking of the demerged co-operative bank is transferred in a demerger; or
 - (2) any co-operative bank formed as a result of demerger.

Illustration 19

Alpha Co-operative Bank amalgamated with Beta Co-operative Bank on 1.12.2014. The depreciation for the year ended 31.3.2015 calculated as per Income-tax Rules, 1962, allowable to Alpha Co-operative Bank had the amalgamation had not taken place amounts to ₹ 2,40,000. Compute the deduction on account of depreciation allowable in the hands of Alpha Co-operative Bank and Beta Co-operative Bank for A.Y. 2015-16.

Solution

- (i) The amount of deduction allowable to the amalgamating co-operative bank (i.e. Alpha Co-operative bank, in this case) under section 32 has to be determined in accordance with the following formula -

$$A \times \frac{B}{C}$$

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.

B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e. 1.4.2014, in this case) and ending on the day immediately preceding the date of business reorganization (i.e. 30.11.2014, in this case); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).

- (ii) The amount of deduction allowable to the amalgamated co-operative bank (i.e. Beta Co-operative bank, in this case) under section 32 has to be determined in accordance with the formula -

$$A \times \frac{B}{C}$$

A = the amount of deduction allowable to the predecessor co-operative bank (i.e. Alpha Co-operative bank, in this case) if the business reorganisation had not taken place. In this case, the amount of deduction is ₹ 2,40,000.

B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.12.2014, in this case) and ending on the last day of the financial year (i.e. 31.3.2015); and

C = the total number of days in the financial year in which the business reorganisation has taken place (i.e. 365 days).

- (iii) In this case, the deduction that would have been allowable under section 32 to Alpha co-operative bank had the business reorganization had not taken place is ₹ 2,40,000 and the business re-organisation took place on 1.12.2014. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be ₹ 1,60,438 i.e., ₹ 2,40,000 x 244/365. The deduction allowable to Beta co-operative bank would be ₹ 79,562 i.e., ₹ 2,40,000 x 121/365.

3.27 Computation of business income in cases where income is partly agricultural and partly business in nature

(i) Income from the manufacture of rubber [Rule 7A]

(1) Income derived from the sale of centrifuged latex or cenex or latex based crepes or brown crepes or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India shall be computed as if it were income derived from business, and 35% of such income shall be deemed to be income liable to tax.

(2) In computing such income, an allowance shall be made in respect of the cost of planting rubber plants in replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of section 10, is not includible in the total income.

(ii) Income from the manufacture of coffee [Rule 7B]

(1) Income derived from the sale of coffee grown and cured by the seller in India shall be computed as if it were income derived from business, and 25% of such income shall be deemed to be income liable to tax.

(2) Income derived from the sale of coffee grown cured, roasted and grounded by the seller in India, with or without mixing of chicory or other flavouring ingredients, shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

(3) In computing such income, an allowance shall be made in respect of the cost of planting coffee plants in such replacement of plants that have died or become permanently useless in

an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of section 10, is not includible in the total income.

(iii) Income from the manufacture of tea [Rule 8]

(1) Income derived from the sale of tea grown and manufactured by the seller in India shall be computed as if it were income derived from business, and 40% of such income shall be deemed to be income liable to tax.

(2) In computing such income, an allowance shall be made in respect of the cost of planting bushes in replacement of bushes that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provision of section 10(31), is not includible in the total income.

UNIT – 4 : CAPITAL GAINS

Learning Objectives

After studying this unit, you would be able to understand –

- ◆ what is the scope of income chargeable under this head
- ◆ the year in which the capital gains is chargeable to tax
- ◆ which assets are “capital assets” for the purposes of chargeability under this head
- ◆ the meaning of short-term capital asset and long-term capital asset
- ◆ how to compute the period of holding for determining whether an asset is a short-term capital asset or long-term capital asset
- ◆ the meaning of transfer for the purpose of capital gains
- ◆ which are the transactions not regarded as transfer
- ◆ the mode of computation of capital gains
- ◆ when cost to previous owner is to be taken as cost of acquisition
- ◆ how to compute capital gains in case of depreciable assets
- ◆ how to compute capital gains in case of slump sale
- ◆ what are the exemptions available in respect of capital gains
- ◆ when an Assessing Officer can make a reference to the Valuation Officer
- ◆ what is the tax treatment of short-term and long-term capital gains in respect of sale of equity shares/ units of an equity oriented fund
- ◆ what is the rate of tax on long-term capital gains

4.1 Introduction

In this chapter on capital gains, the discussion begins with the definition of capital asset and transfer and then the various circumstances under which capital gains tax is levied are enumerated. There are certain transactions which are not to be regarded as transfer for the purposes of capital gains. These transactions have also been discussed in this chapter. For computing long-term capital gains, knowledge of cost inflation index is necessary. Again, there is a separate method of computation of capital gains in respect of depreciable assets. Also, there are exemptions from capital gains under certain circumstances. All these are discussed in this chapter.

Section 45 provides that any profits or gains arising from the transfer of a capital asset effected in the previous year will be chargeable to income-tax under the head ‘Capital Gains’. Such capital gains will be deemed to be the income of the previous year in which the transfer took place. In this charging section, two terms are important. One is “capital asset” and the other is “transfer”.

4.2 Capital Asset

(1) **Definition:** According to section 2(14), a capital asset means –

(a) property of any kind held by an assessee, whether or not connected with his business or profession;

(b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the SEBI regulations.

However, it does not include—

(i) **any stock-in-trade [other than securities referred to in (b) above]**, consumable stores or raw materials held for the purpose of the business or profession of the assessee;

The exclusion of stock-in-trade from the definition of capital asset is only in respect of sub-clause (a) above and not sub-clause (b). This implies that even if the nature of such security in the hands of the Foreign Portfolio Investor is stock in trade, the same would be treated as a capital asset and the profit on transfer would be taxable as capital gains.

Further, the Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that the income arising from transfer of such security by a Foreign Portfolio Investor (FPI) would be in the nature of capital gain, irrespective of the presence or otherwise in India, of the Fund manager managing the investments of the assessee.

(ii) personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him, but excludes -

(a) jewellery;

(b) archaeological collections;

(c) drawings;

(d) paintings;

(e) sculptures; or

(f) any work of art.

(iii) Rural agricultural land in India i.e., agricultural land in India which is not situated in any specified area.

(iv) 6½% Gold Bonds, 1977, or 7% Gold Bonds, 1980, or National Defence Gold Bonds, 1980, issued by the Central Government;

(v) Special Bearer Bonds, 1991 issued by the Central Government;

(vi) Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

Note – ‘Property’ includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

(2) Rural Agricultural Lands - We can note from the above definition that only rural agricultural lands in India are excluded from the purview of the term 'capital asset'. Hence urban agricultural lands constitute capital assets. Accordingly, the agricultural land described in (a) and (b) below, being land situated within the specified urban limits, would fall within the definition of "capital asset", and transfer of such land would attract capital gains tax -

- (a) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand according to last preceding census, or
- (b) agricultural land situated in any area within such distance, measured aerially, in relation to the range of population according to the last preceding census as shown hereunder -

	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.
(i)	≤ 2 kilometers	> 10,000 ≤ 1,00,000
(ii)	≤ 6 kilometers	> 1,00,000 ≤ 10,00,000
(iii)	≤ 8 kilometers	> 10,00,000

Example

	Area	Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a)	Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.	Is the land situated in this area a capital asset?
(i)	A	1 km	9,000	No
(ii)	B	1.5 kms	12,000	Yes
(iii)	C	2 kms	11,00,000	Yes
(iv)	D	3 kms	80,000	No
(v)	E	4 kms	3,00,000	Yes
(v)	F	5 kms	12,00,000	Yes
(vi)	G	6 kms	8,000	No
(vii)	H	7 kms	4,00,000	No
(viii)	I	8 kms	10,50,000	Yes
(ix)	J	9 kms	15,00,000	No

Explanation regarding gains arising on the transfer of urban agricultural land -

Explanation to section 2(1A) clarifies that capital gains arising from transfer of any agricultural land situated in any non-rural area (as explained above) will not constitute agricultural revenue within the meaning of section 2(1A). In other words, the capital gains arising from the transfer of such urban agricultural lands would not be treated as agricultural income for the purpose of exemption under section 10(1). Hence, such gains would be exigible to tax under section 45.

(3) Other capital assets - It is not possible to enumerate the forms which a capital asset can take. Goodwill, leasehold rights, a partner's right or share in the firm, a manufacturing licence and the right to subscribe for share of a company etc. are all examples of capital asset.

(4) Jewellery - As noted above, jewellery is treated as capital asset and the profits or gains arising from the transfer of jewellery held for personal use are chargeable to tax under the head "capital gains". For this purpose, the expression 'jewellery' includes the following:

- (i) Ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones and whether or not worked or sewn into any wearing apparel;
- (ii) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

(5) Zero Coupon Bond - Section 2(48) defines the expression 'Zero Coupon Bond'. As per this definition, 'zero coupon bond' means a bond issued by any infrastructure capital company or infrastructure capital fund or a public sector company or a scheduled bank on or after 1st June, 2005, in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and which the Central Government may notify in this behalf. Accordingly, the Central Government has specified the following bonds issued on or before 31.3.2009 as zero coupon bonds -

- (i) 10 year zero coupon bonds of HUDCO, SIDBI, NABARD and IDFC;
- (ii) 15 year zero coupon bonds of HUDCO;
- (iii) 15 year zero coupon bonds of Power Finance Corporation; and
- (iv) 10 year zero coupon bonds of National Housing Bank.

The Central Government has also specified the following bonds issued on or before 31.3.2011 as zero coupon bonds -

- (a) Bhavishya Nirman Bond, a 10 year zero coupon bond of National Bank of Agriculture and Rural Development (NABARD), issued on or before 31.3.2011
- (b) 10 year Deep Discount Bond (Zero Coupon Bond) of Rural Electrification Corporation Limited (REC) issued on or before 31.3.2011.

The income on transfer of a ZCB (not being held as stock-in-trade) is to be treated as capital gains. Section 2(47)(iva) provides that maturity or redemption of a ZCB shall be treated as a transfer for the purposes of capital gains tax. ZCBs held for not more than 12 months would

be treated as short term capital assets. Where the period of holding of ZCBs is more than 12 months, the resultant long term capital gains arising on maturity or redemption would be treated in the same manner as applicable to capital gains arising from the transfer of other listed securities or units covered by section 112. Thus, where the tax payable in respect of any income arising from transfer of ZCBs exceeds 10% of the amount of capital gains before giving effect to the provisions of the second proviso to section 48 on indexation, then, such excess shall be ignored for the purpose of computing the tax payable.

The terms "infrastructure capital company" and "infrastructure capital fund" have been defined in section 2(26A) and 2(26B), respectively. For details, refer Chapter 1- Basic Concepts.

4.3 Short-term and long-term capital assets

Section 2(42A) defines short-term capital asset as a capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer. Therefore, a capital asset held by an assessee for more than 36 months immediately preceding the date of its transfer is a long-term capital asset.

However, a security (other than a unit) listed in a recognized stock exchange, or a unit of an equity oriented fund or a unit of the Unit Trust of India or a Zero Coupon Bond will be considered as a long-term capital asset if the same is held for more than 12 months immediately preceding the date of its transfer.

This implies that an unlisted security and unit of a debt-oriented mutual fund would qualify as a "long-term capital asset" and be eligible for the benefit of indexation and concessional rate of tax@20% only if it is held for "more than 36 months".

However, the unlisted securities and units of debt-oriented mutual fund shall be deemed as long-term capital assets if they have been transferred during the period from April 1, 2014 to July 10, 2014, being the date of introduction of the Finance (No.2) Bill, 2014 in the Lok Sabha, after holding them for a period of "more than 12 months" (instead of more than 36 months).

Further, in the case of a capital asset being a share or any other security or a right to subscribe to any share or security where such right is renounced in favour of any other person, the period shall be calculated for treating the capital asset as a short-term capital asset from the date of allotment of such share or security or from the date of offer of such right by the company or institution concerned.

Determination of period of holding - The following points must be noted in this regard:

- (i) In the case of a share held in a company in liquidation, the period subsequent to the date on which the company goes into liquidation should be excluded.
- (ii) Section 49(1) specifies some special circumstances under which capital asset becomes the property of an assessee. For example, an assessee may get a capital asset on a distribution of assets on the partition of a HUF or he may get a gift or he may get the property under a will or from succession, inheritance etc. In such cases, the period for which the asset was held by the previous owner should be taken into account.

(iii) In the case of shares held in an amalgamated company in lieu of shares in the amalgamating company, the period will be counted from the date of acquisition of shares in the amalgamating company.

(iv) In the case of a capital asset being a share or any other security or a right to subscribe to any share or security where such right is renounced in favour of any other person, the period shall be calculated from the date of allotment of such share or security or from the date of offer of such right by the company or institution concerned.

(v) In respect of other capital assets, the period for which any capital asset is held by the assessee shall be determined in accordance with any rules made by the CBDT in this behalf.

(vi) In the case of a capital asset, being a financial asset, allotted without any payment and on the basis of holding of any other financial asset the period shall be reckoned from the date of the allotment of such financial asset.

(vii) In the case of a capital asset being shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, the period of holding shall include the period for which the shares were held in the demerged company by the assessee.

(viii) In the case of a capital asset being equity shares, or trading or clearing rights, of a stock exchange acquired by a person pursuant to demutualization or corporatisation of a recognised stock exchange in India as referred to in clause (xiii) of section 47, there shall be included while calculating the period of holding of such assets the period, for which the person was a member of the recognised stock exchange immediately prior to such demutualization or corporatisation.

(ix) In the case of a capital asset, being any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employee or employees), the period shall be reckoned from the date of allotment or transfer of such specified security or sweat equity shares.

“Specified security” means the securities as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956 and, where employees’ stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme.

“Sweat equity shares” means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

In respect of capital assets other than those listed above, the period of holding shall be determined subject to any rules which the Board may make in this behalf.

4.4 Transfer: What it means [Section 2(47)]

The Act contains an inclusive definition of the term ‘transfer’. Accordingly, transfer in relation to a capital asset includes the following types of transactions :—

- (i) the sale, exchange or relinquishment of the asset; or
- (ii) the extinguishment of any rights therein; or
- (iii) the compulsory acquisition thereof under any law; or

- (iv) the owner of a capital asset may convert the same into the stock-in-trade of a business carried on by him. Such conversion is treated as transfer; or
- (v) the maturity or redemption of a Zero Coupon Bond; or
- (vi) Part-performance of the contract : Sometimes, possession of an immovable property is given in consideration of part-performance of a contract. For example, A enters into an agreement for the sale of his house. The purchaser gives the entire sale consideration to A. A hands over complete rights of possession to the purchaser since he has realised the entire sale consideration. Under Income-tax Act, the above transaction is considered as transfer; or
- (vii) Lastly, there are certain types of transactions which have the effect of transferring or enabling the enjoyment of an immovable property. For example, a person may become a member of a co-operative society, company or other association of persons which may be building houses/flats. When he pays an agreed amount, the society etc. hands over possession of the house to the person concerned. No conveyance is registered. For the purpose of income-tax, the above transaction is a transfer. Even power of attorney transactions are covered.

Note – Section 2(47) provides an inclusive definition of “transfer”, in relation to a capital asset. Explanation 2 to section 2(47) clarifies that ‘transfer’ includes and shall be deemed to have always included –

- | | | |
|---|---|---|
| (1) disposing of or parting with an asset or any interest therein, or | } | - directly or indirectly,
- absolutely or conditionally, |
| (2) creating any interest in any asset in any manner whatsoever | } | - voluntarily or involuntarily |

by way of an agreement (whether entered into in India or outside India) or otherwise.

The above transactions would be deemed as a transfer notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

4.5 Scope and year of chargeability [Section 45]

(i) General Provision [Section 45(1)] - Any profits or gains arising from the transfer of a capital asset effected in the previous year (other than exemptions covered under this chapter) shall be chargeable to Income-tax under this head in the previous year in which the transfer took place.

(ii) Receipts from insurance parties [Section 45(1A)] - Where any person receives any money or other assets under any insurance from an insurer on account of damage to or destruction of any capital asset, as a result of flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature, riot or civil disturbance, accidental fire or explosion or because of action by an enemy or action taken in combating an enemy (whether with or without declaration of war), then, any profits or gains arising from receipt of such money or other assets shall be chargeable to income-tax under the head “Capital gains” and shall be deemed to be the income of the such person for the previous year in which money or other asset was received.

For the purposes of section 48, the value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital assets.

(iii) Conversion or treatment of a capital asset as stock-in-trade [Section 45(2)] - A person who is the owner of a capital asset may convert the same or treat it as stock-in-trade of the business carried on by him. As noted above, the above transaction is a transfer. As per section 45(2), the profits or gains arising from the above conversion or treatment will be chargeable to income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him. In order to compute the capital gains, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received as a result of the transfer of the capital asset.

Illustration 1

A is the owner of a car. On 1-4-2014, he starts a business of purchase and sale of motor cars. He treats the above car as part of the stock-in-trade of his new business. He sells the same on 31-3-2015 and gets a profit of ₹ 1 lakh. Discuss the tax implication.

Solution

Since car is a personal asset, conversion or treatment of the same as the stock-in-trade of his business will not be trapped by the provisions of section 45(2). Hence A is not liable to capital gains tax.

Illustration 2

X converts his capital asset (acquired on June 10, 1988 for ₹ 60,000) into stock-in-trade in March 10, 2014. The fair market value on the date of the above conversion was ₹ 5,50,000. He subsequently sells the stock-in-trade so converted for ₹ 6,00,000 on June 10, 2014. Discuss the tax implication.

Solution

Since the capital asset is converted into stock-in-trade during the previous year relevant to the A.Y. 2014-15, it will be a transfer under section 2(47) during the P.Y.2013-14. However, the profits or gains arising from the above conversion will be chargeable to tax during the A.Y. 2015-16, since the stock-in-trade has been sold only on June 10, 2014. For this purpose, the fair market value on the date of such conversion (i.e. 10th March, 2014) will be the full value of consideration.

The capital gains will be computed after deducting the indexed cost of acquisition from the full value of consideration. The cost inflation index for 1988-89 i.e., the year of acquisition is 161 and the index for the year of transfer i.e., 2013-14 is 939. The indexed cost of acquisition is $60,000 \times 939/161 = ₹ 3,49,938$. Hence, ₹ 2,00,062 (i.e. ₹ 5,50,000 – ₹ 3,49,938) will be treated as long-term capital gains chargeable to tax during the A.Y.2015-16. During the same assessment year, ₹ 50,000 (₹ 6,00,000 - ₹ 5,50,000) will be chargeable to tax as business profits.

Year of chargeability - Capital gains are chargeable as the income of the previous year in which the sale or transfer takes place. In other words, for determining the year of chargeability, the relevant date of transfer is not the date of the agreement to sell, but the actual date of sale *i.e.*, the date on which the effect of transfer of title to the property as contemplated by the parties has taken place [*Alapati Venkatramiah v. CIT [1965] 57 ITR 185 (SC)*]. Thus, in the case of any immovable property of the value exceeding ₹ 100, the title to the property cannot pass from the transferor to the transferee until and unless a deed of conveyance is executed and registered. Mere delivery of possession of the immovable property could not itself be treated as equivalent to conveyance of the immovable property. In the case of any movable property, the title to which would pass immediately on delivery of the property in accordance with the agreement to sell, the transfer will be complete on such delivery. However, as already noted, Income-tax Act has recognised certain transactions as transfer in spite of the fact that conveyance deed might not have been executed and registered. Power of Attorney sales as explained above or co-operative society transactions for acquisition of house are examples in this regard.

(iv) Transfer of beneficial interest in securities [Section 45(2A)] - As per section 45(2A), where any person has had at any time during the previous year any beneficial interest in any securities, then, any profits or gains arising from the transfer made by the Depository or participant of such beneficial interest in respect of securities shall be chargeable to tax as the income of the beneficial owner of the previous year in which such transfer took place and shall not be regarded as income of the depository who is deemed to be the registered owner of the securities by virtue of sub-section (1) of section 10 of the Depositories Act, 1996. For the purposes of section 48 and proviso to section 2(42A), the cost of acquisition and the period of holding of securities shall be determined on the basis of the first-in-first-out (FIFO) method.

When the securities are transacted through stock exchanges, it is the established procedure that the brokers first enter into contracts for purchase/sale of securities and thereafter, follow it up with delivery of shares, accompanied by transfer deeds duly signed by the registered holders. The seller is entitled to receive the consideration agreed to as on the date of contract. Thus, it is the date of broker's note that should be treated as the date of transfer in case of sale transactions of securities provided such transactions are followed up by delivery of shares and also the transfer deeds. Similarly, in respect of the purchasers of the securities, the holding period shall be reckoned to take place directly between the parties and not through stock exchanges. The date of contract of sale as declared by the parties shall be treated as the date of transfer provided it is followed up by actual delivery of shares and the transfer deeds.

Where securities are acquired in several lots at different points of time, the First-In-First-Out (FIFO) method shall be adopted to reckon the period of the holding of the security, in cases where the dates of purchase and sale could not be correlated through specific numbers of the scrips. In other words, the assets acquired last will be taken to be remaining with the assessee while assets acquired first will be treated as sold. Indexation, wherever applicable, for long-term assets will be regulated on the basis of the holding period determined in this manner - *CBDT Circular No. 704, dated 28.4.1995*.

"Beneficial owner" means a person whose name is recorded as such with a depository.

"Depository" means a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under section 12(1A) of the Securities and Exchange Board of India Act, 1992.

"Security" means such security as may be specified by SEBI.

(v) Introduction of capital asset as capital contribution [Section 45(3)] - Where a person transfers a capital asset to a firm, AOP or BOI in which he is already a partner/member or is to become a partner/member by way of capital contribution or otherwise, the profits or gains arising from such transfer will be chargeable to tax as income of the previous year in which such transfer takes place. For this purpose, the value of the consideration will be the amount recorded in the books of account of the firm, AOP or BOI as the value of the capital asset.

Illustration 3

A is the owner of a foreign car. He starts a firm in which he and his two sons are partners. As his capital contribution, he transfers the above car to the firm. The car had cost him ₹ 2,00,000. The same is being introduced in the firm at a recorded value of ₹ 3,50,000. Discuss.

Solution

Car is not capital asset but is a personal effect. Section 45(3), as explained above, covers only cases of transfer of capital asset as contribution and not personal effects. Hence, the above transaction will not be subject to capital gains tax.

(vi) Distribution of capital assets on a firm's dissolution [Section 45(4)] - The profits or gains arising from the transfer of capital assets by way of distribution of capital assets on the dissolution of a firm or AOP or BOI or otherwise shall be chargeable to tax as the income of the firm etc. of the previous year in which such transfer takes place. For this purpose, the fair market value of the asset on the date of such transfer shall be the full value of consideration.

The Bombay High Court made a landmark judgment in *Commissioner of Income-tax v. A.N. Naik Associates (2004) 136 Taxman 107*. The Court applied the "mischief rule" about interpretation of statutes and pointed out that the idea behind the introduction of sub-section (4) in section 45 was to plug in a loophole and block the escape route through the medium of the firm. The High Court observed that the expression 'otherwise' has not to be read *ejusdem generis* with the expression 'dissolution of a firm or body of individuals or association of persons'. The expression 'otherwise' has to be read with the words 'transfer of capital assets by way of distribution of capital assets'. If so read, it becomes clear that even when a firm is in existence and there is a transfer of capital asset, it comes within the expression 'otherwise' since the object of the amendment was to remove the loophole which existed, whereby capital gains tax was not chargeable. Therefore, the word 'otherwise' takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of retiring partners.

(vii) **Compensation on compulsory acquisition [Section 45(5)]** - Sometimes, a building or some other capital asset belonging to a person is taken over by the Central Government by way of compulsory acquisition. In that case, the consideration for the transfer is determined by the Central Government. When the Central Government pays the above compensation, capital gains may arise. Such capital gains are chargeable as income of the previous year in which such compensation is received.

Enhanced Compensation - Many times, persons whose capital assets have been taken over by the Central Government and who get compensation from the government go to the court of law for enhancement of compensation. If the court awards a compensation which is higher than the original compensation, the difference thereof will be chargeable to capital gains in the year in which the same is received from the government. For this purpose, the cost of acquisition and cost of improvement shall be taken to be *nil*.

Compensation received in pursuance of an interim order deemed as income chargeable to tax in the year of final order

In order to remove the uncertainty regarding the year in which the amount of compensation received in pursuance of an interim order of the court is to be charged to tax, a proviso has been inserted after clause (b) to provide that such compensation shall be deemed to be income chargeable under the head 'Capital gains' in the previous year in which the final order of such court, Tribunal or other authority is made.

Reduction of enhanced compensation - Where capital gain has been charged on the compensation received by the assessee for the compulsory acquisition of any capital asset or enhanced compensation received by the assessee and subsequently such compensation is reduced by any court, tribunal or any authority, the assessed capital gain of that year shall be recomputed by taking into consideration the reduced amount. This re-computation shall be done by way of rectification under section 155.

Death of the transferor - It is possible that the transferor may die before he receives the enhanced compensation. In that case, the enhanced compensation or consideration will be chargeable to tax in the hands of the person who received the same.

Note - *Since the tax treatment accorded to a LLP and a general partnership is the same, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. However, if there is a change in rights and obligations of partners or there is a transfer of asset or liability after conversion, then the provisions of section 45 would get attracted.*

4.6 Capital gains on distribution of assets by companies in liquidation [Section 46]

(1) Where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of section 45 [Section 46(1)]. The above section is restricted in its application to the circumstances

mentioned therein *i.e.*, the assets of the company must be distributed in specie to shareholders on the liquidation of the company. If, however, the liquidator sells the assets of the company resulting in a capital gain and distributes the funds so collected, the company will be liable to pay tax on such gains.

(2) Shareholders receive money or other assets from the company on its liquidation. They will be chargeable to income-tax under the head 'capital gains' in respect of the market value of the assets received on the date of distribution, or the moneys so received by them. The portion of the distribution which is attributable to the accumulated profits of the company is to be treated as dividend income of the shareholder under section 2(22)(c). The same will be deducted from the amount received/fair market value for the purpose of determining the consideration for computation of capital gains.

(3) Capital gains tax on subsequent sale by the shareholders - If the shareholder, after receipt of any such asset on liquidation of the company, transfers it within the meaning of section 45 at a price which is in excess of his cost of acquisition determined in the manner aforesaid, such excess becomes taxable in his hands under section 45.

4.7 Capital gains on buyback, etc. of shares [Section 46A]

Any consideration received by a shareholder or a holder of other specified securities from any company on purchase of its own shares or other specified securities held by such shareholder or holder of other specified securities shall be chargeable to tax on the difference between the cost of acquisition and the value of consideration received by the holder of securities or by the shareholder, as the case may be, as capital gains. The computation of capital gains shall be made in accordance with the provisions of section 48.

Such capital gains shall be chargeable in the year in which such shares/securities were purchased by the company. For this purpose, "specified securities" shall have the same meaning as given in *Explanation* to section 77A of the Companies Act, 1956.

However, in case of buyback of unlisted shares by domestic companies, additional income-tax@20% (*plus* surcharge@10% and cess@3%) is leviable in the hands of the company. Consequently, the income arising to the shareholders in respect of such buyback of unlisted shares by the domestic company would be exempt under section 10(34A), where the company is liable to pay additional income-tax on the buyback of shares.

(1)	(2)	(3)
Taxability in the hands of the -	Buyback of unlisted shares by domestic companies	Buyback of shares other than shares referred to in column (2)
Company	Subject to additional income-tax@22.66%.	Not subject to tax in the hands of the company.
Shareholders	Income arising to shareholders exempt under section 10(34A)	Income arising to shareholders taxable as capital gains under section 46A.

4.8 Transactions not regarded as transfer [Section 47]

Section 47 specifies certain transactions which will not be regarded as transfer for the purpose of capital gains tax:

- (1) Any distribution of capital assets on the total or partial partition of a HUF;
- (2) Any transfer of a capital asset under a gift or will or an irrevocable trust;

However, this clause shall not include transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees' Stock Option Plan or Scheme offered to its employees in accordance with the guidelines issued in this behalf by the Central Government.

- (3) Any transfer of a capital asset by a company to its subsidiary company.

Conditions - (i) The parent company must hold the whole of the shares of the subsidiary company; (ii) The subsidiary company must be an Indian company.

- (4) Any transfer of capital asset by a subsidiary company to a holding company;

Conditions - (i) The whole of shares of the subsidiary company must be held by the holding company; (ii) The holding company must be an Indian company.

Exception - The exemption mentioned in 3 or 4 above will not apply if a capital asset is transferred as stock-in-trade.

- (5) Any transfer in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company.

- (6) Any transfer in a scheme of amalgamation of shares held in an Indian company by the amalgamating foreign company to the amalgamated foreign company.

Conditions - (i) At least 25 percent of the shareholders of the amalgamating foreign company must continue to remain shareholders of the amalgamated foreign company; (ii) Such transfer should not attract capital gains in the country in which the amalgamating company is incorporated.

- (7) Any transfer, in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949, of a capital asset by such banking company to such banking institution.

- (8) Any transfer by a shareholder in a scheme of amalgamation of shares held by him in the amalgamating company.

Conditions - (i) The transfer is made in consideration of the allotment to him of any share in the amalgamated company, except where the shareholder itself is the amalgamated company; (ii) The amalgamated company is an Indian company.

For example, let us take a case where A Ltd., an Indian company, holds 60% of shares in B Ltd. B Ltd. amalgamates with A Ltd. Since A Ltd. itself is the shareholder of B Ltd., A Ltd., being the amalgamated company, cannot issue shares to itself. However, A Ltd. has to issue

shares to the other shareholders of B Ltd.

Illustration 4

M held 2000 shares in a company ABC Ltd. This company amalgamated with another company during the previous year ending 31-3-2015. Under the scheme of amalgamation, M was allotted 1000 shares in the new company. The market value of shares allotted is higher by ₹ 50,000 than the value of holding in ABC Ltd. The Assessing Officer proposes to treat the transaction as an exchange and to tax ₹ 50,000 as capital gain. Is he justified?

Solution

In the above example, assuming that the amalgamated company is an Indian company, the transaction is squarely covered by the exemption explained above and the proposal of the Assessing Officer to treat the transaction as an exchange is not justified.

(9) Any transfer in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.

(10) Any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerger foreign company to the resulting foreign company.

Conditions - (i) The shareholders holding at least three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and

(ii) Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

However, the provisions of sections 391 to 394 of the Companies Act, 1956, shall not apply in case of demergers referred to in this clause.

(11) any transfer in a business reorganisation, of a capital asset by the predecessor co-operative bank to the successor co-operative bank.

(12) any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank.

Note – Refer to section 44DDB for the meanings of “business reorganisation”, “predecessor co-operative bank” and “successor co-operative bank”.

(13) Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.

(14) Any transfer of bonds or Global Depository Receipts referred to in section 115AC(1).

Conditions - (i) The transfer must be made outside India; (ii) The transfer must be made by the non-resident to another non-resident.

(15) any transfer of a capital asset, -

- (i) being a Government Security carrying a periodic payment of interest,*
- (ii) made outside India through an intermediary dealing in settlement of securities,*
- (iii) by a non-resident to another non-resident*

This is for the purpose of facilitating listing and trading of Government securities outside India

(16) Any transfer of agricultural lands effected before 1-3-1970.

(17) Any transfer of any of the following capital asset to the government or to the University or the National Museum, National Art Gallery, National Archives or any other public museum or institution notified by the Central Government to be of (national importance or to be of) renown throughout any State :

- (i) work of art
- (ii) archaeological, scientific or art collection
- (iii) book
- (iv) manuscript
- (v) drawing
- (vi) painting
- (vii) photograph or
- (viii) print.

(18) Any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company into shares or debentures of that company.

(19) Any transfer by way of conversion of Foreign Currency Exchangeable Bonds into shares or debentures of a company.

(20) Transfer by way of exchange of a capital asset being membership of a recognised stock exchange for shares of a company to which such membership is transferred.

Conditions - (i) Such exchange is effected on or before 31st December, 1998 and (ii) such shares are retained by the transferor for a period of not less than three years from the date of transfer.

(21) Capital gains arising from the transfer of land under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985, by a sick industrial company which is managed by its workers' co-operative.

Conditions - Such transfer is made in the period commencing from the previous year in which the said company has become a sick industrial company and ending with the previous year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

(22) Where a firm is succeeded by a company or where an AOP or BOI is succeeded by a company in the course of demutualisation or corporatisation of a recognised stock exchange in India, any transfer of a capital asset or intangible asset (in the case of a firm).

Conditions - (i) All assets and liabilities of the firm or AOP or BOI relating to the business immediately before the succession become the assets and liabilities of the company;

(ii) All the partners of the firm immediately before the succession become the shareholders of the company and the proportion in which their capital accounts stood in the books of the firm on the date of succession remains the same;

(iii) The partners of the firm do not receive any consideration or benefit in any form, directly or indirectly, other than by way of allotment of shares in the company.

(iv) The partners of the firm together hold not less than 50% of the total voting power in the company, and their shareholding continues in such manner for a period of 5 years from the date of succession.

(v) The corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation approved by SEBI.

(23) any transfer of a membership right by a member of recognised stock exchange in India for acquisition of shares and trading or clearing rights in accordance with a scheme for demutualization or corporatisation approved by SEBI.

(24) any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP or any transfer of a share or shares held in a company by a shareholder on conversion of a company into a LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45, subject to fulfillment of certain conditions, namely:

(i) the total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lakh in any of the three preceding previous years;

(ii) the shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company;

(iii) no consideration other than share in profit and capital contribution in the LLP arises to the shareholders;

(iv) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion;

(v) all assets and liabilities of the company become the assets and liabilities of the LLP; and

(vi) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.

(25) Where a sole proprietary concern is succeeded by a company in the business carried out by it, as a result of which the sole proprietary concern transfers or sells any capital asset or intangible asset to such company.

Conditions - (i) All assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;
(ii) The sole proprietor holds not less than 50% of the total voting power in the company, and his shareholding continues in such manner for a period of 5 years from the date of succession;
(iii) The sole proprietor does not receive any consideration or benefit in any form, directly or indirectly, other than by way of allotment of shares in the company.

(26) Any transfer in a scheme for lending of any securities under an agreement or arrangement which the assessee has entered into with the borrower of such securities and which is subject to the guidelines issued by SEBI or the RBI, for example, the Securities Lending and Borrowing (SLB) Scheme for all market participants in the Indian securities market under the overall framework of Securities Lending Scheme, 1997 of SEBI.

(27) Any transfer of a capital asset in a scheme of reverse mortgage under a scheme made and notified by the Central Government.

Illustration 5

In which of the following situations capital gains tax liability does not arise?

- (i) Mr. A purchased gold in 1970 for ₹ 25,000. In the P.Y. 2014-15, he gifted it to his son at the time of marriage. Fair market value (FMV) of the gold on the day the gift was made was ₹ 1,00,000.
- (ii) A house property is purchased by a Hindu undivided family in 1945 for ₹ 20,000. It is given to one of the family members in the P.Y. 2014-15 at the time of partition of the family. FMV on the day of partition was ₹ 12,00,000.
- (iii) Mr. B purchased 50 convertible debentures for ₹ 40,000 in 1995 which are converted in to 500 shares worth ₹ 85,000 in November 2014 by the company.

Solution

We know that capital gains arise only when we transfer a capital asset. The liability of capital gains tax in the situations given above is discussed as follows:

- (i) As per the provisions of section 47(iii), transfer of a capital asset under a gift is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.
- (ii) As per the provisions of section 47(i), transfer of a capital asset (being in kind) on the total or partial partition of Hindu undivided family is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.
- (iii) As per the provisions of section 47(x), transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form of a company into shares or debentures of that company is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

4.9 Important Definitions

(a) Amalgamation [Section 2(1B)] - "Amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that -

- (i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
- (ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) shareholders holding not less than three-fourth in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation, otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

(b) Demerger [Section 2(19AA)] - "Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956, by a demerged company of its one or more undertaking to any resulting company in such a manner that -

- (i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;
- (ii) all the liabilities relating to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- (iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
- (iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;

Note - *If the resulting company is a shareholder of the demerged company, it cannot issue shares to itself. However, the resulting company has to issue shares to the other shareholders of the demerged company.*

- (v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger,

or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) the transfer of the undertaking is on a going concern basis;

(vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf.

Explanation 1 - For the purposes of this clause, "undertaking" shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Explanation 2 - For the purposes of this clause, the liabilities referred to in sub-section (ii), shall include-

- (a) the liabilities which arise out of the activities or operations of the undertaking;
- (b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and
- (c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Explanation 3 - For determining the value of the property referred to in sub-clause (iii), any change in the value of assets consequent to their revaluation shall be ignored.

Explanation 4 - For the purposes of this clause, the splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified by the Central Government in the Official Gazette.

"Demerged company" means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.

4.10 Withdrawal of exemption in certain cases

Section 47A provides for withdrawal of the benefit of exemption given by section 47 in certain cases.

As noted above, capital gains arising from the transfer of a capital asset by a company to its wholly owned subsidiary company is exempt from tax. Similarly, capital gains arising from the transfer of a capital asset by the subsidiary company to the holding company is also exempt

from tax, provided under both circumstances the transferee is an Indian company.

Section 47A provides that the above exemption will be withdrawn in the following cases:

- (1) Where at any time before the expiry of eight years from the date of transfer of a capital asset referred to above, such capital asset is converted by the transferee company or is treated by it as stock-in-trade of its business;
- (2) Where before eight years as noted above, the parent company or its nominee ceases to hold the whole of the share capital of the subsidiary company.

In the above two cases, the amount of capital gains exempt from tax by virtue of the provisions contained in section 47 will be deemed to be the income of the transferor company chargeable under the head 'capital gains' of the year in which such transfer took place.

- (3) Capital gains not charged to tax under clause (xi) of section 47 shall be deemed to be the income chargeable under the head "capital gains" of the previous year in which such transfer took place if the shares of the company received in exchange for transfer of membership in a recognised stock exchange are transferred at any time before the expiry of three years of such transfer.

- (4) Where any of the conditions laid down in section 47 for succession of a firm or sole proprietary concern by a company are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset shall be deemed to be the profits and gains chargeable to tax of the successor company for the previous year in which the conditions are not complied with.

- (5) If subsequent to the conversion of a company into an LLP, any of the conditions laid down in section 47(xiiib) are not complied with, the capital gains not charged under section 45 would be deemed to be chargeable to tax in the previous year in which the conditions are not complied with, in the hands of the LLP or the shareholder of the predecessor company, as the case may be.

4.11 Mode of computation of capital gains

- (i) The income chargeable under the head 'capital gains' shall be computed by deducting the following items from the full value of the consideration received or accruing as a result of the transfer of the capital asset:

- (1) Expenditure incurred wholly and exclusively in connection with such transfer.
- (2) The indexed cost of acquisition and indexed cost of any improvement thereto.

- (ii) However, no deduction shall be allowed in computing the income chargeable under the head "Capital Gains" in respect of any amount paid on account of securities transaction tax under Chapter VII of the Finance (No.2) Act, 2004.

Under section 48, the cost of acquisition will be increased by applying the cost inflation index (CII). Once the cost inflation index is applied to the cost of acquisition, it becomes indexed cost of acquisition. This means an amount which bears to the cost of acquisition, the same proportion

as CII for the year in which the asset is transferred bears to the CII for the first year in which the asset was held by the assessee or for the year beginning on 1st April, 1981, whichever is later. Similarly, indexed cost of any improvement means an amount which bears to the cost of improvement, the same proportion as CII for the year in which the asset is transferred bears to the CII for the year in which the improvement to the asset took place. CII for any year means such index as the Central Government may, having regard to 75% of the average rise in the consumer price index for urban non-manual employees (UNME) for the immediately preceding previous year to that year by notification in the Official Gazette, specify in this behalf.

Since the release of CPI for UNME has been discontinued, accordingly, w.e.f. A.Y.2016-17, "Cost Inflation Index" in relation to a previous year shall mean such index as may be notified by the Central Government having regard to 75% of average rise in the Consumer Price Index (Urban) for the immediately preceding previous year to such previous year.

Note - The benefit of indexation will not apply to the long-term capital gains arising from the transfer of bonds or debentures other than capital indexed bonds issued by the Government.

In case of depreciable assets (discussed later), there will be no indexation or the capital gains will always be short-term capital gains.

(iii) Cost Inflation Index: The cost inflation indices for the financial years so far have been notified as under:

Financial Year	Cost Inflation Index	Financial Year	Cost Inflation Index
1981-82	100	1998-99	351
1982-83	109	1999-00	389
1983-84	116	2000-01	406
1984-85	125	2001-02	426
1985-86	133	2002-03	447
1986-87	140	2003-04	463
1987-88	150	2004-05	480
1988-89	161	2005-06	497
1989-90	172	2006-07	519
1990-91	182	2007-08	551
1991-92	199	2008-09	582
1992-93	223	2009-10	632
1993-94	244	2010-11	711
1994-95	259	2011-12	785
1995-96	281	2012-13	852
1996-97	305	2013-14	939
1997-98	331	2014-15	1024

As noted above, for the financial year 1981-82, CII is 100 and the CII for each subsequent year would be determined in such a way that 75% of the rise in consumer price index for urban non-manual employees would be reflected in the rise in CII. It would be seen that the date of transfer of an asset would be immaterial as long as it is within a particular financial year. That means, transfer of assets in any part of the year would be subject to indexation using the same CII as applicable to an asset transferred on 1st April of the year. The effect is that all the assets transferred during the year will be deemed to be sold on the first day of the year.

(iv) Special provision for non-residents - In order to give protection to non-residents who invest foreign exchange to acquire capital assets, section 48 contains a proviso. Accordingly, in the case of non-residents, capital gains arising from the transfer of shares or debentures of an Indian company is to be computed as follows:

The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares were acquired. The resulting capital gains shall be reconverted into Indian currency. The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures in an Indian company. Rule 115A is relevant for this purpose.

Non-residents and foreign companies to be subject to tax at a concessional rate of 10% (without indexation benefit or currency fluctuation) on long-term capital gains arising from transfer of unlisted securities [Section 112]

Under section 115AD, where the total income of a Foreign Institutional Investor includes long-term capital gains on sale of unlisted securities, the same would be taxable@10%, without the benefit of indexation or currency fluctuation. In order to bring parity in tax rate on long-term capital gains (arising on sale of unlisted securities) applicable to non-residents and FIIs, section 112 provides that in the case of non-corporate non-residents and foreign companies, long-term capital gains arising from transfer of unlisted securities would be subject to tax@10% without giving effect to indexation provision under second proviso to section 48 and currency fluctuation under first proviso to section 48.

4.12 Ascertainment of Cost in Specified Circumstances [Section 49]

A person becomes the owner of a capital asset not only by purchase but also by several other methods. Section 49 gives guidelines as to how to compute the cost under different circumstances.

(1) In the following cases, the cost of acquisition of the asset shall be deemed to be cost for which the previous owner of the property acquired it. To this cost, the cost of improvement to the asset incurred by the previous owner or the assessee must be added:

Where the capital asset became the property of the assessee:

- (i) on any distribution of assets on the total or partition of a HUF;
- (ii) under a gift or will;

- (iii) by succession, inheritance or devaluation;
- (iv) on any distribution of assets on the liquidation of a company;
- (v) under a transfer to revocable or an irrevocable trust;
- (vi) under any transfer by a holding company to its 100% subsidiary Indian company or vice versa;
- (vii) under any scheme of amalgamation by the amalgamating company to the amalgamated Indian company;
- (viii) by transfer of shares held in an Indian company in a scheme of amalgamation by the amalgamating foreign company to the amalgamated foreign company;
- (ix) by transfer of capital asset by a banking company to a banking institution in a scheme of amalgamation of the banking company with the banking institution;
- (x) under any such transfer of a capital asset in a business reorganization by the predecessor co-operative bank to the successor co-operative bank;
- (xi) under any such transfer by a shareholder in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank;
- (xii) on conversion of a company into an LLP;
- (xiii) on succession of a firm or sole proprietorship concern by a company in a business carried on by it, fulfilling the conditions mentioned in section 47(xiii) and section 47(xiv), respectively;
- (xiv) by conversion by an individual of his separate property into a HUF property, by the mode referred to in section 64(2).

The cost of acquisition of the asset is the cost for which the previous owner acquired the asset as increased by the cost of any improvement of the assets incurred or borne by the previous owner or the assessee, as the case may be. Accordingly, section 2(42A) provides that in all such cases, for determining the period for which the capital asset is held by the transferee, the period of holding of the asset by the previous owner shall also be considered.

Note: The issue as to whether indexation benefit in respect of a gifted asset shall apply from the year in which the asset was first held by the assessee or from the year in which the same was first acquired by the previous owner was taken up by the Bombay High Court in *CIT v. Manjula J. Shah* 16 Taxman 42 (Bom.).

As per *Explanation 1* to section 2(42A), in case the capital asset becomes the property of the assessee in the circumstances mentioned in section 49(1), inter alia, by way of gift by the previous owner, then for determining the nature of the capital asset, the aggregate period for which the capital asset is held by the assessee and the previous owner shall be considered.

As per the provisions of section 48, the profit and gains arising on transfer of a long-term capital asset shall be computed by reducing the indexed cost of acquisition from the net sale consideration. The indexed cost of acquisition means the amount which bears to the cost of acquisition the same proportion as Cost Inflation Index (CII) for the year in which the asset is transferred bears to the CII for the year in which the asset was first held by the assessee transferring it i.e., the year in which the asset was gifted to the assessee in case of transfer by the previous owner by way of gift.

In the present case, the assessee had acquired a capital asset by way of gift from the previous owner. The said asset when transferred was a long-term capital asset considering the period of holding by the assessee as well as the previous owner. The assessee computed the long-term capital gain considering the CII of the year in which the asset was first held by the previous owner. The Assessing Officer raised an objection mentioning that as per meaning assigned to the Indexed cost of acquisition, the CII of the year in which the asset is first held by the assessee need to be considered and not the CII of the year in which the asset was first held by the previous owner.

In the present case, the Bombay High Court held that by way of 'deemed holding period fiction' created by the statute, the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly the asset is a long term capital asset in the hands of the assessee. Therefore, for determining the indexed cost of acquisition under section 48, the assessee must be treated to have held the asset from the year the asset was first held by the previous owner and accordingly the CII for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.

Hence, the Bombay High Court held that the indexed cost of acquisition in case of gifted asset has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.

As per the plain reading of the provisions of section 48, however, the indexed cost of acquisition would be determined by taking CII for the year in which in which asset is first held by the assessee.

Illustration 6

Neerja was carrying on the textile business under a proprietorship concern, Neerja Textiles. On 21.07.2014 the business of Neerja Textiles was succeeded by New Look Textile Private Limited and all the assets and liabilities of Neerja Textiles on that date became the assets and liabilities of New Look Textile Private Limited and Neerja was given 52% share in the share capital of the company. No other consideration was given to Neerja on account of this succession.

The assets and liabilities of Neerja Textiles transferred to the company included an urban land which was acquired by Neerja on 19.7.2011 for ₹ 9,80,000. The company sold the same on 30.03.2015 for ₹ 15,00,000.

Discuss the tax implication of the above mentioned transaction and compute the income chargeable to tax in such case(s).

Answer

Taxability in case of succession of Neerja Textiles by New Look Textile Private Limited

As per provisions of section 47(xiv), in case a proprietorship concern is succeeded by a company in the business carried by it and as a result of which any capital asset is transferred to the company, then the same shall not be treated as transfer and will not be chargeable to capital gain tax in case the following conditions are satisfied:

- (1) all the assets and liabilities of sole proprietary concern becomes the assets and liabilities of the company.
- (2) the shareholding of the sole proprietor in the company is not less than 50% of the total voting power of the company and continues to so remain as such for a period of 5 years from the date of succession.
- (3) the sole proprietor does not receive any consideration or benefit in any form from the company other than by way of allotment of shares in the company.

In the present case, all the conditions mentioned above are satisfied therefore, the transfer of capital asset by Neerja Textiles to New Look Textiles Private Limited shall not attract capital gain tax provided Neerja continues to hold 50% or more of voting power of New Look Textiles Private Limited for a minimum period of 5 years.

Taxability in case of transfer of land by New Look Textiles Private Limited

As per the provisions of section 49(1) and *Explanation 1* to section 2(42A), in case a capital asset is transferred in the circumstances mentioned in section 47(xiv), the cost of the asset in the hands of the company shall be the cost of the asset in the hands of the sole proprietor. Consequently, for the determining the period of holding of the asset, the period for which the asset is held by the sole proprietor shall also be considered.

Therefore, in the present case, the urban land shall be a long-term capital asset since it is held for more than 36 months by New Look Textile Private Limited and Neerja Textiles taken together. Cost of acquisition of land in the hands of the company shall be ₹ 9,80,000 i.e., the purchase cost of the land in the hands of Neerja.

Computation of capital gain chargeable to tax in the hands of New Look Textile Private Ltd.

Particulars	₹
Net Sale Consideration	15,00,000
Less: Indexed cost of acquisition $9,80,000 \times 1024/1024$ (Refer Note below)	<u>9,80,000</u>
Long-term capital gain	<u>5,20,000</u>

Note: The year of transfer and the year in which the company first held the asset are the

same in this case, which is the reason why the numerator and the denominator for calculating the indexed cost of acquisition would remain the same. Therefore, in effect, there is no benefit of indexation in this case. However, as per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by taking the CII of F.Y.2011-12, being the year in which the capital asset was acquired by the previous owner, Neerja, as the denominator, in which case, the capital gains chargeable to tax would undergo a change. The long-term capital gains in such a case would be ₹ 2,21,631 (₹ 15,00,000 - ₹ 12,78,369).

(2) Where shares in an amalgamated company which is an Indian company become the property of the assessee in consideration of the transfer of shares held by him in the amalgamating company under a scheme of amalgamation, the cost of acquisition to him of the shares in the amalgamated company shall be taken as the cost of acquisition of the shares in the amalgamating company [Section 49(2)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of shares in the amalgamated co-operative bank, which became the property of the assessee by virtue of a transfer as a result of business reorganisation shall be the cost of acquisition to him of the shares in the amalgamating co-operative bank.

(3) It is possible that a person might have become the owner of shares or debentures in a company during the process of conversion of bonds or debentures, debenture stock or deposit certificates. In such a case, the cost of acquisition to the person shall be deemed to be that part of the cost of debentures, debenture stock, bond or deposit certificate in relation to which such asset is acquired by that person [Section 49(2A)].

(4) Where the capital gain arises from the transfer of specified security or sweat equity shares referred to in section 17(2)(vi), the cost of acquisition of such security or shares shall be the fair market value which has been taken into account for perquisite valuation [Section 49(2AA)].

(5) If a shareholder of a company receives rights in a partnership firm as consideration for transfer of shares on conversion of a company into a LLP, then the cost of acquisition of the capital asset being rights of a partner referred to in section 42 of the LLP Act, 2008 shall be deemed to be the cost of acquisition to him of the shares in the predecessor company, immediately before its conversion [Section 49(2AAA)].

(6) Where the capital gain arises from the transfer of specified security or sweat equity shares, the cost of acquisition of such security or shares shall be the fair market value which has been taken into account while computing the value of fringe benefits under clause (ba) of sub-section (1) of section 115WC [Section 49(2AB)].

The value of fringe benefits would be the fair market value of the specified security or sweat equity shares on the date on which the option vests with employee as reduced by the amount actually paid by, or recovered from the employee in respect of such security or shares. Fair market value means the value determined in accordance with the method prescribed by the CBDT. This fair market value would be taken as the cost of acquisition of the specified security or sweat equity shares. It may be noted that the amount recovered from the employee is not to be deducted for determining the cost of acquisition.

***Note** – It may be noted that fringe benefit tax is not applicable from A.Y.2010-11 and therefore, the fair market value of the specified securities and sweat equity shares would be taxed as a perquisite in the hands of the employees w.e.f. A.Y.2010-11. Therefore, if specified securities or sweat equity shares have been subject to FBT in the hands of the employer upto A.Y.2009-10, the provisions of section 49(2AB) would apply for determination of the cost of acquisition at the time of transfer. However, if the specified securities or sweat equity shares have been taxed as a perquisite in the hands of the employees w.e.f. A.Y.2010-11, the provisions of section 49(2AA) would apply for determination of the cost of acquisition at the time of transfer of such securities/shares by the employee.*

(7) In the case of a demerger, the cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger [Section 49(2C)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of the shares in the resulting co-operative bank shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged co-operative bank, the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged co-operative bank immediately before demerger i.e.,

$$\text{Cost of acquisition of shares in the resulting co-operative bank} = A \times \frac{B}{C}$$

A = Cost of acquisition of shares held in the demerged co-operative bank

B = Net book value of the assets transferred in a demerger

C = Net worth of the demerged co-operative bank i.e. the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

(8) Further, the cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived under the sub-section (2C) [Section 49(2D)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of the original shares held by the shareholder in the demerged co-operative bank shall be deemed to have been reduced by the amount so arrived at in (6) above.

For the above purpose, "net worth" means the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

Normally speaking, capital gains must be computed after deducting from the sale price the cost of acquisition to the assessee. The various provisions mentioned above form an exception to this general principle.

(9) Where the capital gain arises from the transfer of such property which has been subject to tax under section 56(2)(vii) or section 56(2)(viia), the cost of acquisition of the property shall be deemed to be the value taken into account for the purposes of section 56(2)(vii)/(viia). [For illustration, see Unit 5 of Chapter 4 "Income from Other Sources" under section 56(2)(vii)]

4.13 Cost of improvement [Section 55]

(1) **Goodwill of a business, etc.:** In relation to a capital asset being goodwill of a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, the cost of improvement shall be taken to be Nil.

(2) **Any other capital asset:** (i) Where the capital asset became the property of the previous owner or the assessee before 1-4-1981, cost of improvement means all expenditure of a capital nature incurred in making any addition or alteration to the capital asset on or after the said date by the previous owner or the assessee.

(ii) In any other case, cost of improvement means all expenditure of a capital nature incurred in making any additions or alterations to the capital assets by the assessee after it became his property. However, there are cases where the capital asset might become the property of the assessee by any of the modes specified in section 49(1). In that case, cost of improvement means capital expenditure in making any addition or alterations to the capital assets incurred by the previous owner.

However, cost of improvement does not include any expenditure which is deductible in computing the income chargeable under the head "Income from house property", "Profits and gains of business or profession" or "Income from other sources".

Illustration 7

Mr. X & sons, HUF, purchased a land for ₹ 40,000 in 1991-92. In 1995-96, a partition takes place when Mr. A, a coparcener, is allotted this plot valued at ₹ 80,000. In 1996-97, he had incurred expenses of ₹ 1,85,000 towards fencing of the plot. Mr. A sells this plot of land for ₹ 15,00,000 in 2014-15 after incurring expenses to the extent of ₹ 20,000. You are required to compute the capital gain for the A.Y. 2015-16.

Financial year	Cost Inflation Index
1991-92	199
1995-96	281
1996-97	305
2014-15	1024

Solution**Computation of taxable capital gains for the A.Y. 2015-16**

Particulars	₹	₹
Sale consideration		15,00,000
Less: Expenses incurred for transfer		20,000
		14,80,000
Less: (i) Indexed cost of acquisition (₹ 40,000 × 1024/281)	1,45,765	
(ii) Indexed cost of improvement (₹ 1,85,000 × 1024/305)	6,21,115	7,66,880
Long term capital gains		7,13,120

Note - As per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by considering the Cost Inflation Index of F.Y. 1991-92.

Illustration 8

Mr. B purchased convertible debentures for ₹ 5,00,000 during August 1998. The debentures were converted into shares in September 2002. These shares were sold for ₹ 15,00,000 in August, 2014. The brokerage expenses is ₹ 50,000. You are required to compute the capital gains in case of Mr. B for the assessment year 2015-16.

Financial Year	Cost Inflation Index
1998-99	351
2002-03	447
2014-15	1024

Solution**Computation of Capital Gains of Mr. B for the A.Y.2015-16**

Particulars	₹
Sale consideration	15,00,000
Less: Expenses on transfer i.e. Brokerage paid	50,000
Net consideration	14,50,000
Less: Indexed cost of acquisition (₹ 5,00,000 × 1024/447)	11,45,414
Long term capital gain	3,04,586

Note : For the purpose of computing capital gains, the holding period is considered from the date of allotment of these shares i.e. September 2002 – August 2014.

Illustration 9

Mr. C purchases a house property for ₹ 1,06,000 on May 15, 1963. The following expenses are incurred by him for making addition/allocation to the house property:

	Particulars	₹
a.	Cost of construction of first floor in 1972-73	1,35,000
b.	Cost of construction of the second floor in 1983-84	3,10,000
c.	Reconstruction of the property in 1992-93	2,50,000

Fair market value of the property on April 1, 1981 is ₹ 4,50,000. The house property is sold by Mr. C on August 10, 2014 for ₹ 90,00,000 (expenses incurred on transfer: ₹ 50,000). Compute the capital gain for the assessment year 2015-16.

Financial year	Cost Inflation Index
1981-82	100
1983-84	116
1992-93	223
2014-15	1024

Solution**Computation of capital gain of Mr.C for the A.Y.2015-16**

Particulars	₹	₹
Gross sale consideration		90,00,000
Less: Expenses on transfer		50,000
Net sale consideration		89,50,000
Less: Indexed cost of acquisition (Note 1)	46,08,000	
Less: Indexed cost of improvement (Note 2)	38,84,534	84,92,534
Long-term capital gain		4,57,466

Notes:

Indexed cost of acquisition is computed as follows:

$$₹ 4,50,000 \times 1024/100 = ₹ 46,08,000$$

Fair market value on April 1, 1981 (actual cost of acquisition is ignored as it is lower than market value on April 1, 1981.)

Indexed cost of improvement is determined as under:	₹
Construction of first floor in 1972-73 (expenses incurred prior to April 1, 1981 are not considered)	Nil
Construction of second floor in 1983-84 (i.e., ₹ 3,10,000 × 1024 / 116)	27,36,552
Alternation/reconstruction in 1992-93 (i.e., ₹ 2,50,000 × 1024 / 223)	11,47,982
Indexed cost of improvement	38,84,534

4.14 Cost of Acquisition [Section 55]

(i) **Goodwill of a business or a trademark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, tenancy rights, stage carriage permits and loom hours** - In the case of the above capital assets, if the assessee has purchased them from a previous owner, the cost of acquisition means the amount of the purchase price. For example, if A purchases a stage carriage permit from B for ₹ 2 lacs, that will be the cost of acquisition for A.

(ii) **Self-generated assets** - There are circumstances where it is not possible to visualise cost of acquisition. For example, suppose a doctor starts his profession. With the passage of time, the doctor acquires lot of reputation. He opens a clinic and runs it for 5 years. After 5 years he sells the clinic to another doctor for ₹ 10 lacs which includes ₹ 2 lacs for his reputation or goodwill. Now a question arises as to how to find out the profit in respect of goodwill. It is obvious that the goodwill is self-generated and hence it is difficult to calculate the cost of its acquisition. However, it is certainly a capital asset. The Supreme Court in *CIT v. B.C. Srinivasa Shetty [1981] 128 ITR 294 (SC)* held that in order to bring the gains on sale of capital assets to charge under section 45, it is necessary that the provisions dealing with the levy of capital gains tax must be read as a whole. Section 48 deals with the mode of computing the capital gains. Unless the cost of acquisition is correctly ascertainable, it is not possible to apply the provisions of section 48. Self-generated goodwill is such a type of capital asset where it is not possible to visualise cost of acquisition. Once section 48 cannot be applied, the gains thereon cannot be brought to charge.

This decision of the Supreme Court was applicable not only to self-generated goodwill of a business but also to other self-generated assets like tenancy rights, stage carriage permits, loom hours etc. In order to supersede the decision of the Supreme Court cited above, section 55 was amended. Accordingly, in case of self-generated assets namely, goodwill of a business or a trademark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business, tenancy rights, stage carriage

permits, or loom hours, the cost of acquisition will be taken to be *nil*. However, it is significant to note that the above amendment does not cover self-generated goodwill of a profession. So, in respect of self-generated goodwill of a profession and other self-generated assets not specifically covered by the amended provisions of section 55, the decision of the Supreme Court in *B. C. Srinivasa Setty's* case will still apply.

(iii) Other assets - In the following cases, cost of acquisition shall not be *nil*, but will be deemed to be the cost for which the previous owner of the property acquired it:

Where the capital asset became the property of the assessee—

- (1) On any distribution of assets on the total or partial partition of a Hindu undivided family.
- (2) Under a gift or will.
- (3) By succession, inheritance or devolution.
- (4) On any distribution of assets on the liquidation of a company.
- (5) Under a transfer to a revocable or an irrevocable trust.
- (6) Under any such transfer referred to in sections 47(iv), (v), (vi), (via) or (viaa).
- (7) Where the assessee is a Hindu undivided family, by the mode referred to in section 64(2).

(iv) Financial assets - Many times persons who own shares or other securities become entitled to subscribe to any additional shares or securities. Further, they are also allotted additional shares or securities without any payment. Such shares or securities are referred to as financial assets in Income-tax Act. Section 55 provides the basis for ascertaining the cost of acquisition of such financial assets.

(1) In relation to the original financial asset on the basis of which the assessee becomes entitled to any additional financial assets, cost of acquisition means the amount actually paid for acquiring the original financial assets.

(2) In relation to any right to renounce the said entitlement to subscribe to the financial asset, when such a right is renounced by the assessee in favour of any person, cost of acquisition shall be taken to be *nil* in the case of such assessee.

(3) In relation to the financial asset, to which the assessee has subscribed on the basis of the said entitlement, cost of acquisition means the amount actually paid by him for acquiring such asset.

(4) In relation to the financial asset allotted to the assessee without any payment and on the basis of holding of any other financial assets, cost of acquisition shall be taken to be nil in the case of such assessee. In other words, where bonus shares are allotted without any payment on the basis of holding of original shares, the cost of such bonus shares will be nil in the hands of the original shareholder. However, in respect of bonus shares allotted before 1.4.81, although the cost of acquisition of the shares is nil, the assessee may opt for the fair market value as on 1.4.81 as the cost of acquisition of such bonus shares.

(5) In the case of any financial asset purchased by the person in whose favour the right to subscribe to such assets has been renounced, cost of acquisition means the aggregate of the

amount of the purchase price paid by him to the person renouncing such right and the amount paid by him to the company or institution for acquiring such financial asset.

(6) In relation to equity shares allotted to a shareholder of a recognised stock exchange in India under a scheme for demutualisation or corporatisation approved by SEBI, the cost of acquisition shall be the cost of acquiring his original membership of the exchange.

(7) The cost of a capital asset, being trading or clearing rights of a recognised stock exchange acquired by a shareholder (who has been allotted equity share or shares under such scheme of demutualisation or corporatisation), shall be deemed to be nil.

(v) Any other capital asset - (1) Where the capital asset become the property of the assessee before 1-4-1981 cost of acquisition means the cost of acquisition of the asset to the assessee or the fair market value of the asset on 1-4-1981 at the option of the assessee.

(2) Where the capital asset became the property of the assessee by any of the modes specified in section 49(1), it is clear that the cost of acquisition to the assessee will be the cost of acquisition to the previous owner. Even in such cases, where the capital asset became the property of the previous owner before 1-4-1981, the assessee has got a right to opt for the fair market value as on 1-4-1981.

(3) Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation and the assessee has been assessed to capital gains in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution.

(4) A share or a stock of a company may become the property of an assessee under the following circumstances :

- (a) the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares.
- (b) the conversion of any shares of the company into stock,
- (c) the re-conversion of any stock of the company into shares,
- (d) the sub-division of any of the shares of the company into shares of smaller amount, or
- (e) the conversion of one kind of shares of the company into another kind.

In the above circumstances the cost of acquisition to the assessee will mean the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.

(vi) Where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner.

Illustration 10

ABC Ltd., converts its capital asset acquired for an amount of ₹ 50,000 in June, 1991 into stock-in-trade in the month of November, 2012. The fair market value of the asset on the date of conversion is ₹ 2,50,000. The stock-in-trade was sold for an amount of ₹ 3,50,000 in the month of December, 2014. What will be the tax treatment?

<i>Financial year</i>	<i>Cost Inflation Index</i>
1991-92	199
2012-13	852
2014-15	1024

Solution

The capital gains on the sale of the capital asset converted to stock-in-trade is taxable in the given case. It arises in the year of conversion (i.e. P.Y. 2012-13) but will be taxable only in the year in which the stock-in-trade is sold (i.e. P.Y. 2014-15). Profits from business will also be taxable in the year of sale of the stock-in-trade (P.Y. 2014-15).

The long-term capital gains and business income for the A.Y.2015-16 are calculated as under:

Particulars	₹	₹
Profits and Gains from Business or Profession		
Sale proceeds of the stock-in-trade	3,50,000	
Less: Cost of the stock-in-trade (FMV on the date of conversion)	<u>2,50,000</u>	1,00,000

Long Term Capital Gains

Full value of the consideration (FMV on the date of the conversion)	2,50,000	
Less: Indexed cost of acquisition (₹ 50,000 x 852/199)	<u>2,14,070</u>	35,930

Note: For the purpose of indexation, the cost inflation index of the year in which the asset is converted into stock-in-trade should be considered.

Illustration 11

Ms. Usha purchases 1,000 equity shares in X Ltd. at a cost of ₹ 15 per share (brokerage 1%) in January 1978. She gets 100 bonus shares in August 1980. She again gets 1100 bonus shares by virtue of her holding on February 1985. Fair market value of the shares of X Ltd. on April 1, 1981 is ₹ 25. In January 2015, she transfers all her shares @ ₹ 150 per share (brokerage 2%).

Compute the capital gains taxable in the hands of Ms. Usha for the A.Y. 2015-16 assuming:

- X Ltd is an unlisted company and securities transaction tax was not applicable at the time of sale.*
- X Ltd is a listed company and the shares are sold in a recognised stock exchange and securities transaction tax was paid at the time of sale.*

Cost Inflation Index for F.Y. 1981-82 : 100, F.Y.1984-85 : 125 & F.Y.2014-15 : 1024.

Solution

(a) Computation of capital gains for the A.Y. 2015-16

Particulars	₹
1000 Original shares	
Sale proceeds (1000 × ₹ 150)	1,50,000
Less : Brokerage paid (2% of ₹ 1,50,000)	3,000
Net sale consideration	1,47,000
Less : Indexed cost of acquisition [₹ 25 × 1000 × 1024/100]	2,56,000
Long term capital loss (A)	1,09,000
100 Bonus shares	
Sale proceeds (100 × ₹ 150)	15,000
Less : Brokerage paid (2% of ₹ 15,000)	300
Net sale consideration	14,700
Less : Indexed cost of acquisition [₹ 25 × 100 × 1024/100] [See Note below]	25,600
Long term capital loss (B)	10,900
1100 Bonus shares	
Sale proceeds (1100 × ₹ 150)	1,65,000
Less: Brokerage paid (2% of ₹ 1,65,000)	3,300
Net sale consideration	1,61,700
Less: Cost of acquisition	NIL
Long term capital gain (C)	1,61,700
∴ Long term capital gain (A+B+C)	41,800

Note: Cost of acquisition of bonus shares acquired before 1.4.1981 is the FMV as on 1.4.1981 (being the higher of the cost or the FMV as on 1.4.1981).

- (b) The long-term capital gains on transfer of equity shares through a recognized stock exchange on which securities transaction tax is paid is exempt from tax under section 10(38). Hence, the taxable capital gain for A.Y.2015-16 is Nil.

Illustration 12

On January 31, 2015, Mr. A has transferred self-generated goodwill of his profession for a sale consideration of ₹ 70,000 and incurred expenses of ₹ 5,000 for such transfer. You are required to compute the capital gains chargeable to tax in the hands of Mr. A for the A.Y. 2015-16.

Solution

The transfer of self-generated goodwill of profession is not chargeable to tax. It is based upon the Supreme Court's ruling in *CIT vs. B.C. Srinivasa Shetty*.

Illustration 13

Mr. R holds 1000 shares in Star Minus Ltd., an unlisted company, acquired in the year 1981-82 at a cost of ₹ 25,000. He has been offered right shares by the company in the month of August, 2014 at ₹ 140 per share, in the ratio of 2 for every 5 held. He retains 50% of the rights and renounces the balance right shares in favour of Mr. Q for ₹ 25 per share in September 2014. All the shares are sold by Mr. R for ₹ 300 per share in January 2015 and Mr. Q sells his shares in December 2014 at ₹ 280 per share.

What are the capital gains taxable in the hands of Mr. R and Mr. Q?

Financial year	Cost Inflation Index
1981-82	100
2014-15	1024

Solution**Computation of capital gains in the hands of Mr. R for the A.Y.2015-16**

Particulars	₹
1000 Original shares	
Sale proceeds (1000 × ₹ 300)	3,00,000
Less : Indexed cost of acquisition [₹ 25,000 × 1024/100]	2,56,000
Long term capital gain (A)	44,000
200 Right shares	
Sale proceeds (200 × ₹ 300)	60,000
Less : Cost of acquisition [₹ 140 × 200] [Note 1]	28,000
Short term capital gain (B)	32,000
Sale of Right Entitlement	
Sale proceeds (200 × ₹ 25)	5,000
Less : Cost of acquisition [Note 2]	NIL
Short term capital gain (C)	5,000
Capital Gains (A+B+C)	81,000

Note 1: Since the holding period of these shares is less than 3 years, they are short term capital assets and hence cost of acquisition will not be indexed.

Note 2: The cost of the rights renounced in favour of another person for a consideration is taken to be nil. The consideration so received is taxed as short-term capital gains in full. The period of holding is taken from the date of the rights offer to the date of the renouncement.

Computation of capital gains in the hands of Mr. Q for the A.Y.2015-16

Particulars	₹
200 shares :	
Sale proceeds (200 × ₹ 280)	56,000
<i>Less: Cost of acquisition [200 shares × (₹ 25 + ₹ 140)] [See Note below]</i>	33,000
Short term capital gain	23,000

Note: The cost of the rights is the amount paid to Mr. R as well as the amount paid to the company. Since the holding period of these shares is less than 3 years, they are short term capital assets.

4.15 Computation of capital gains in case of depreciable assets [Sections 50 & 50A]

(i) Section 50 provides for the computation of capital gains in case of depreciable assets. It may be noted that where the capital asset is a depreciable asset forming part of a block of assets, section 50 will have overriding effect in spite of anything contained in section 2(42A) which defines a short-term capital asset.

Accordingly, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed, the provisions of sections 48 and 49 shall be subject to the following modification:

Where the full value of consideration received or accruing for the transfer of the asset plus the full value of such consideration for the transfer of any other capital asset falling with the block of assets during previous year exceeds the aggregate of the following amounts namely:

- (1) expenditure incurred wholly and exclusively in connection with such transfer;
 - (2) WDV of the block of assets at the beginning of the previous year;
 - (3) the actual cost of any asset falling within the block of assets acquired during the previous year
- such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

Where all assets in a block are transferred during the previous year, the block itself will cease to exist. In such a situation, the difference between the sale value of the assets and the WDV of the block of assets at the beginning of the previous year together with the actual cost of any asset falling within that block of assets acquired by the assessee during the previous year will be deemed to be the capital gains arising from the transfer of short-term capital assets.

(ii) **Cost of acquisition in case of power sector assets [Section 50A]:** With respect to the power sector, in case of depreciable assets referred to in section 32(1)(i), the provisions of sections 48 and 49 shall apply subject to the modification that the WDV of the asset (as defined in section 43(6)), as adjusted, shall be taken to be the cost of acquisition.

4.16 Capital gains in respect of slump sale [Section 50B]

(i) Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

Short term capital gains - Any profits and gains arising from such transfer of one or more undertakings held by the assessee for not more than thirty-six months shall be deemed to be short-term capital gains [Sub-section (1)].

(ii) The net worth of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 in relation to capital assets of such undertaking or division transferred by way of such sale and the provisions contained in the second proviso to section 48 shall be ignored [Sub-section (2)].

(iii) Every assessee in the case of slump sale shall furnish in the prescribed form along with the return of income, a report of a chartered accountant indicating the computation of net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section [Sub-section (3)].

Explanation 1 to the section defines the expression "net worth" as the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in the books of account. However, any change in the value of assets on account of revaluation of assets shall not be considered for this purpose.

Explanation 2 provides that the aggregate value of total assets of such undertaking or division shall be as follows:

- (i) In the case of depreciable assets: the written down value of block of assets determined in accordance with the provisions contained in sub-item (C) of item (i) of section 43(6)(c);
- (ii) In case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD : Nil;
- (ii) for all other assets : Book value.

4.17 Special Provision for Full Value of Consideration in Certain Cases [Section 50C]

(i) Where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed *or assessable* by any authority of a State Government (Stamp Valuation Authority) for the purpose of payment of stamp duty in respect of such asset, such value adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer [Sub-section (1)].

(ii) Where the assessee claims before an Assessing Officer that the value so adopted or assessed or assessable by the authority for payment of stamp duty exceeds the fair market value of the property as on the date of transfer and the value so adopted or assessed or assessable by such authority has not been disputed in any appeal or revision or no reference

has been made before any other authority, court or High Court, the Assessing Officer may refer the valuation of the capital asset to a valuation officer as defined in section 2(r) of the Wealth-tax Act, 1957. Where any reference has been made before any other authority, Court or the High Court, the provisions of section 16A (relating to reference to Valuation Officer), section 23A (dealing with appealable orders before Commissioner (Appeals), section 24 (order of Appellate Tribunal), section 34AA (appearance by registered valuer), section 35 (rectification of mistakes) and section 37 (power to take evidence on oath) of the Wealth-tax Act, 1957, shall, with necessary modifications, apply in relation to such reference as they apply in relation to a reference made by the Assessing Officer under sub-section (1) of section 16A of that Act [Sub-section (2)].

(iii) Where the value ascertained by such valuation officer exceeds the value adopted or assessed or assessable by the Stamp authority the value adopted or assessed *or assessable* shall be taken as the full value of the consideration received or accruing as a result of the transfer [Sub-section (3)].

(iv) The term "assessable" has been added to cover transfers executed through power of attorney. The term 'assessable' has been defined to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

4.18 Fair market value of the capital asset on the date of transfer to be taken as sale consideration, in cases where the consideration is not determinable [Section 50D]

Section 50D provides that, in case where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, **the fair market value of the said asset on the date of transfer** shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

4.19 Advance money received [Section 51]

It is possible for an assessee to receive some advance in regard to the transfer of capital asset. Due to the break-down of the negotiation, the assessee may have retained the advance. Section 51 provides that while calculating capital gains, the above advance retained by the assessee must go to reduce the cost of acquisition. However, if advance has been received and retained by the previous owner and not the assessee himself, then the same will not go to reduce the cost of acquisition of the assessee.

The Finance (No.2) Act, 2014 has inserted new clause (ix) in section 56(2) to provide for the taxability of any sum of money, received as an advance or otherwise in the course of negotiations for transfer of a capital asset. Consequently, such sum shall be chargeable to income-tax under the head 'Income from other sources', if such sum is forfeited on or after 1st April, 2014 and the negotiations do not result in transfer of such capital asset.

In order to avoid double taxation of the advance received and retained, section 51 provides that where any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset has been included in the total income of the assessee for any previous year in accordance with section 56(2)(ix), then, such amount shall not be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

However, any such sum of money forfeited before 1st April, 2014, will be deducted from the cost of acquisition for computing capital gains.

Illustration 14

Mr. Kay purchases a house property on April 10, 1978 for ₹ 35,000. The fair market value of the house property on April 1, 1981 was ₹ 70,000. On August 31, 1984, Mr. Kay enters into an agreement with Mr. Jay for sale of such property for ₹ 1,20,000 and received an amount of ₹ 10,000 as advance. However, as Mr. Jay did not pay the balance amount, Mr. Kay forfeited the advance. In May 1987, Mr. Kay constructed the first floor by incurring a cost of ₹ 50,000. Subsequently, in September 1987, Mr. Kay gifted the house to his friend Mr. Dee. On February 10, 2015, Mr. Dee sold the house for ₹ 10,00,000. CII for F.Y. 1984-85 : 125; 1987-88: 150; 2014-15:1024. Compute the capital gains in the hands of Mr. Dee for A.Y.2015-16.

Solution

Computation of taxable capital gains of Mr. Dee for A.Y.2015-16

Particulars	₹	₹
Sale consideration		10,00,000
Less: Indexed cost of acquisition (See Note below)	4,77,867	
Indexed cost of improvement (See Note below)	3,41,333	8,19,200
Long-term capital gain		1,80,800

For the purpose of capital gains, holding period is considered from the date on which the house was purchased by Mr. Kay, till the date of sale. However, indexation of cost of acquisition is considered from the date on which the house was gifted by Mr. Kay to Mr. Dee, till the date of sale. i.e. from September 1987 (P.Y. 1987-88) to February 2015 (P.Y. 2014-15).

Indexed cost of acquisition = $(₹ 70,000 \times 1024/150) = ₹ 4,77,867$

Indexed cost of improvement = $(₹ 50,000 \times 1024/150) = ₹ 3,41,333$

Amount forfeited by previous owner, Mr. Kay, will not be considered.

Note - As per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexed cost of acquisition would have to be calculated by taking the CII of F.Y.1981-82, since the Fair Market Value as on 1.4.1981 has been taken as the cost of acquisition.

Illustration 15

Mr. X purchases a house property in December 1975 for ₹ 1,25,000 and an amount of ₹ 75,000 was spent on the improvement and repairs of the property in March, 1981. The property was proposed to be sold to Mr. Z in the month of May, 2003 and an advance of ₹ 40,000 was taken from him. As the entire money was not paid in time, Mr. X forfeited the advance and subsequently sold the property to Mr. Y in the month of March, 2015 for ₹ 40,00,000. The fair value of the property on April 1, 1981 was ₹ 3,90,000. What is the capital gain chargeable in the hands of Mr. X for the A.Y. 2015-16?

Financial year	Cost Inflation Index
1981-82	100
2003-04	463
2014-15	1024

Solution

Capital gains in the hands of Mr. X for the A.Y. 2015-16 is computed as under:

Particulars	₹
Sale proceeds	40,00,000
Less : Indexed cost of acquisition [Note 1]	35,84,000
Indexed cost of improvement [Note 2]	-
Long term capital gains	4,16,000

Note 1: Computation of indexed cost of acquisition

Cost of acquisition (higher of fair market value as on April 1, 1981 and the actual cost of acquisition)	3,90,000
Less : Advance taken and forfeited	<u>40,000</u>
Cost for the purposes of indexation	<u>3,50,000</u>
Indexed cost of acquisition (₹ 3,50,000 x 1024/100)	35,84,000

Note 2 : Any improvement cost incurred prior to 1.4.1981 is to be ignored when fair market value as on 1.4.1981 is taken into consideration.

4.20 Exemption of capital gains**(i) Capital Gains on sale of residential house [Section 54]**

Eligible assessee – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of residential house (buildings or lands appurtenant thereto)
- It must be a long-term capital asset
- Income from such house should be chargeable under the head "Income from house"

property"

- **One residential house in India** should be –
 - purchased within 1 year before or 2 years after the date of transfer (or)
 - constructed within a period of 3 years after the date of transfer.

Quantum of Exemption

- If cost of new residential house \geq Capital gains, entire capital gains is exempt.
- If cost of new residential house $<$ Capital gains, capital gains to the extent of cost of new residential house is exempt

Examples

- Example 1 - If the capital gains is ₹ 5 lakhs and the cost of the new house is ₹ 7 lakhs, then the entire capital gains of ₹ 5 lakhs is exempt.
- Example 2 - If capital gains is ₹ 5 lakhs and cost of new house is ₹ 3 lakhs, then capital gains is exempt only upto ₹ 3 lakhs. Balance ₹ 2 lakhs is taxable @ 20%.

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its acquisition, then cost of the asset will be reduced by capital gains exempted earlier for computing short-term capital gains.
- Continuing Example 1, if the new house was sold after 2 years for ₹ 8 lakhs, then short term capital gain chargeable to tax would be –

Particulars	₹	₹
Net Consideration		8,00,000
Less: Cost of acquisition	7,00,000	
Less: Capital gains exempt earlier	5,00,000	2,00,000
Short term capital gains chargeable to tax		6,00,000

Illustration 16

Mr. Cee purchased a residential house on July 20, 2011 for ₹ 10,00,000 and made some additions to the house incurring ₹ 2,00,000 in August 2011. He sold the house property in April 2014 for ₹ 20,00,000. Out of the sale proceeds, he spent ₹ 5,00,000 to purchase another house property in September 2014.

Financial year	Cost Inflation Index
2011-12	785
2014-15	1024

What is the amount of capital gains taxable in the hands of Mr. Cee for the A.Y.2015-16?

Solution

The house is sold before 36 months from the date of purchase. Hence, the house is a short-term capital asset and no benefit of indexation would be available.

Particulars	₹
Sale consideration	20,00,000
Less: Cost of acquisition	10,00,000
Cost of improvement	2,00,000
Short-term capital gains	8,00,000

Note: The exemption of capital gains under section 54 is available only in case of long-term capital asset. As the house is short-term capital asset, Mr. Cee cannot claim exemption under section 54. Thus, the amount of taxable short-term capital gains is ₹ 8,00,000.

(ii) Capital Gains on transfer of agricultural land [Section 54B]

Eligible assessee – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of urban agricultural land.
- Such land must have been used for agricultural purposes by the assessee, being an individual or his parent, or a HUF in the 2 immediately preceding years.
- He should purchase another agricultural land (urban or rural) within 2 years from the date of transfer.

Quantum of exemption

- If cost of new agricultural land \geq Capital gains (short-term or long-term), entire capital gains is exempt.
- If cost of new agricultural land $<$ Capital gains (short-term or long-term), capital gains to the extent of cost of new agricultural land is exempt.

Examples

- **Example 1** - If the capital gains is ₹ 3 lakhs and the cost of the new agricultural land is ₹ 4 lakhs, then the entire capital gains of ₹ 3 lakhs is exempt.
- **Example 2** - If capital gains is ₹ 3 lakhs and cost of new agricultural land is ₹ 2 lakhs, then capital gains is exempt only upto ₹ 2 lakhs.

Consequences of transfer of new agricultural land before 3 years

- If the new agricultural land is transferred before 3 years from the date of its acquisition, then cost of the land will be reduced by capital gains exempted earlier for computing short-term capital gains.
- However, if the new agricultural land is a rural agricultural land, there would be no capital gains on transfer of such land.

Continuing Example 1, if the new agricultural land (urban land) is sold after, say, 2 years for ₹ 6 lakhs, then short term capital gain chargeable to tax would be –

Particulars	₹	₹
Net consideration		6,00,000
Less: Cost of new agricultural land		
Cost of acquisition	4,00,000	
Less: Capital gains exempt earlier	3,00,000	
		1,00,000
Short-term capital gains chargeable to tax		5,00,000

(iii) Capital Gains on transfer by way of compulsory acquisition of land and building [Section 54D]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There must be compulsory acquisition of land and building forming part of an industrial undertaking.
- The land and building should have been used by the assessee for purposes of the business of the industrial undertaking in the 2 years immediately preceding the date of transfer.
- The assessee must purchase any other land or building or construct any building (for shifting or re-establishing the existing undertaking or setting up a new industrial undertaking) within 3 years from the date of transfer.

Quantum of exemption

- If cost of new asset \geq Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new asset $<$ Capital gains, capital gains (short-term or long-term) to the extent of cost of new asset is exempt.

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its acquisition, then cost of the asset will be reduced by capital gains exempted earlier for computing short-term capital gains.

Illustration 17

PQR Ltd., purchased a building for industrial undertaking in May 2003, at a cost of ₹ 4,00,000. The above property was compulsorily acquired by the State Government at a compensation of ₹ 12,00,000 in the month of January, 2015. The compensation was received in March, 2015. The company purchased another building for its industrial undertaking at a cost of ₹ 2,00,000 in the month of March, 2015. What is the amount of the capital gains chargeable to tax in the hands of the company for the A.Y. 2015-16?

<i>Financial year</i>	<i>Cost Inflation Index</i>
2003-04	463
2014-15	1024

Solution**Computation of capital gains in the hands of PQR Ltd. for the A.Y.2015-16**

Particulars	₹
Sale proceeds (Compensation received)	12,00,000
Less : Indexed cost of acquisition [₹ 4,00,000 × 1024/463]	8,84,665
	3,15,335
Less: Exemption under section 54D (Cost of acquisition of new undertaking)	2,00,000
Taxable long term capital gain	1,15,335

(iv) Capital Gains not chargeable on investment in certain bonds [Section 54EC]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There should be transfer of a long-term capital asset.
- Such asset can also be a depreciable asset held for more than 36 months.
- The capital gains arising from such transfer should be invested in a long-term specified asset within 6 months from the date of transfer.
- Long-term specified asset means specified bonds, redeemable after 3 years, issued by the National Highways Authority of India (NHAI) or the Rural Electrification Corporation Limited (RECL).
- The assessee should not transfer or convert or avail loan or advance on the security of such bonds for a period of 3 years from the date of acquisition of such bonds.

Other points

- In case of conversion of capital asset into stock in trade and subsequent sale of stock in trade - period of 6 months to be reckoned from the date of sale of stock in trade for the purpose of section 54EC exemption [CBDT Circular No.791 dated 2-6-2000].

- Receipt of money on liquidation of company – is chargeable to tax in the hands of shareholders [Section 46(2)] – However, there is no transfer of capital asset in such a case – Therefore, exemption under section 54EC is not available – *CIT v. Ruby Trading Co. (P) Ltd. 259 ITR 54 (Raj.)*

Quantum of exemption

- Capital gains or amount invested in specified bonds, whichever is lower.
- *The maximum investment which can be made in bonds of NHAI and RECL, out of capital gains arising from transfer of one or more assets, during the previous year in which the original asset is transferred and in the subsequent financial year cannot exceed Rs.50 lakhs.*

Violation of condition

- In case of transfer or conversion of such bonds or availing loan or advance on security of such bonds before the expiry of 3 years, the capital gain exempted earlier shall be taxed as long-term capital gain in the year of violation of condition.

(v) Capital gains in cases of investment in residential house [Section 54F]

Eligible assessee: Individuals / HUFs

Conditions to be fulfilled

- There must be transfer of a long-term capital asset, not being a residential house.
- Transfer of plot of land is also eligible for exemption
- The assessee should -
 - Purchase **one residential house situated in India** within a period of 1 year before or 2 years after the date of transfer; or
 - Construct **one residential house in India** within 3 years from the date of transfer.
- The assessee should not own more than one residential house on the date of transfer.
- The assessee should not –
 - purchase any other residential house within a period of one year or
 - construct any other residential house within a period of 3 years
 from the date of transfer of the original asset.

Quantum of exemption

- If cost of new residential house \geq Net sale consideration of original asset, entire capital gains is exempt.
- If cost of new residential house $<$ Net sale consideration of original asset, only proportionate capital gains is exempt i.e.

$$\text{LTCG} \times \frac{\text{Amount invested in new residential house}}{\text{Net sale consideration}}$$

Illustration 18

From the following particulars, compute the taxable capital gains of Mr.D for A.Y.2015-16-

Cost of jewellery [Purchased in F.Y.1990-91]	₹ 1,82,000
Sale price of jewellery sold in January 2015	₹ 11,50,000
Expenses on transfer	₹ 7,000
Residential house purchased in March 2015	₹ 5,00,000

Solution**Computation of taxable capital gains for A.Y.2015-16**

Particulars	₹
Gross consideration	11,50,000
Less: Expenses on transfer	<u>7,000</u>
Net consideration	11,43,000
Less: Indexed cost of acquisition ($\text{₹ } 1,82,000 \times 1024/182$)	<u>10,24,000</u>
	1,19,000
Less: Exemption under section 54F ($\text{₹ } 1,19,000 \times \text{₹ } 5,00,000 / \text{₹ } 11,43,000$)	<u>52,056</u>
Taxable capital gains	<u>66,944</u>

Consequences if the new house is transferred within a period of 3 years

- Short-term capital gains would arise on transfer of the new house; and
- The capital gains exempt earlier under section 54F would be taxable as long-term capital gains.
- In the given illustration, if the new residential house is sold for ₹ 6,00,000 after say, 1 year, then
 - ₹ 1,00,000 [i.e. ₹ 6,00,000 (-) ₹ 5,00,000] would be chargeable as short-term capital gain of that year in which the new house is sold.
 - ₹ 52,056, being the capital gains exempt earlier, would be taxable as long-term capital gains of that year in which the new house is sold.

(vi) Capital gains for shifting of industrial undertaking from urban areas [Section 54G]

Eligible assessee: Any assessee

Conditions to be fulfilled

- There should be a shifting of the industrial undertaking from an urban area to any other area.
- There should be a transfer of machinery, plant, building or land or any right in building or land used for the business of an industrial undertaking situated in an urban area.
- Such transfer should be in the course of or in consequence of shifting the industrial undertaking from an urban area to any other area.

- The capital gain (short-term or long-term) should be utilized for any of the following purposes within 1 year before or 3 years after the date of transfer –
 - purchase of new plant and machinery
 - acquisition of building or land or construction of building
 - expenses on shifting of the industrial undertaking from the urban area to the other area
 - such other expenditure as the Central Government may specify

Quantum of exemption

- If cost of new assets plus expenses incurred for the specified purpose \geq Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new assets plus expenses incurred for the specified purpose $<$ Capital gains, capital gains (short-term or long-term) to the extent of such cost and expenses is exempt.

Consequences if the new asset is transferred within a period of 3 years

- If the new asset is transferred within a period of 3 years of its purchase or construction, then the capital gain, which was exempt earlier under section 54G would be deducted from the cost of acquisition of the new asset for the purpose of computation of short-term capital gains in respect of the transfer of the new asset

(vii) Exemption of capital gains on transfer of certain capital assets in case of shifting of an industrial undertaking from an urban area to any SEZ [Section 54GA]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There must be transfer of capital assets
- Such transfer must be effected in the course of, or in consequence of the shifting of an industrial undertaking from an urban area to any SEZ, whether developed in an urban area or not.
- The capital asset should be either machinery or plant or building or land or any rights in building or land used for the purposes of the business of an industrial undertaking situated in an urban area.
- The assessee should, within a period of 1 year before or 3 years after the date of transfer,
 - purchase machinery or plant for the purposes of business of the industrial undertaking in the SEZ;
 - acquire building or land or construct building for the purposes of his business in the SEZ;
 - shift the industrial undertaking and transfer the establishment of such undertaking to the SEZ; and
 - incur expenses for such other purposes as may be specified in a scheme framed by the Central Government.

Quantum of exemption

- If cost of new assets plus expenses incurred for shifting \geq Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new assets plus expenses incurred for shifting $<$ Capital gains, capital gains (short-term or long-term) to the extent of such cost and expenses is exempt.

Consequences if the new asset is transferred within a period of 3 years

- If the new asset is transferred within a period of 3 years of its purchase or construction, then the capital gain, which was exempt earlier under section 54G would be deducted from the cost of acquisition of the new asset for the purpose of computation of short-term capital gains in respect of the transfer of the new asset.

(viii) Exemption of long-term capital gains on transfer of residential property if the sale consideration is used for subscription in equity of a new start-up manufacturing SME company to be used for purchase of new plant and machinery [Section 54GB]

- (1) The National Manufacturing Policy (NMP) was announced by the Government in 2011 to encourage investment in the SME segment (Small and Medium Enterprises) in the manufacturing sector.
- (2) Section 54GB exempt long term capital gains on sale of a residential property (house or plot of land) owned by an individual or a HUF in case of re-investment of sale consideration in the equity shares of an eligible company being a newly incorporated SME company engaged in the manufacturing sector, which is utilized by the company for the purchase of new plant and machinery.
- (3) In order to qualify as an "eligible company" under section 54GB the company should be –
 - (i) incorporated in the financial year in which the capital gain arises or in the following year on or before the due date of filing return of income by the individual or HUF;
 - (ii) engaged in the business of manufacture of an article or thing;
 - (iii) a company in which the individual or HUF holds more than 50% of the share capital or 50% of the voting rights, after the subscription in shares by the individual or HUF; and
 - (iv) a company which qualifies to be a Small or Medium Enterprise (SME) under the Micro, Small and Medium Enterprises Development Act, 2006 i.e., investment in the equipment is more than ₹ 25 lakhs but less than ₹ 10 crore.
- (4) The following conditions should be satisfied for claim of exemption of long-term capital gains under this section -
 - (i) The amount of net consideration should be used by the individual or HUF before the due date of furnishing of return of income under section 139(1), for subscription in equity shares of the eligible company.
 - (ii) The amount of subscription as share capital is to be utilized by the eligible company for the purchase of new plant and machinery within a period of one year from the date of subscription in the equity shares.

- (iii) If the amount of net consideration subscribed as equity shares in the eligible company is not utilized by the company for the purchase of plant and machinery before the due date of filing of return by the individual or HUF, the unutilized amount shall be deposited in an account with any specified bank or institution before such due date of filing return of income. The return of income furnished by the assessee, should be accompanied by the proof of such deposit.
 - (iv) The said amount is to be utilized in accordance with any scheme which may be notified by the Central Government in the Official Gazette.
- (5) The amount of net consideration utilized by the company for purchase of new plant and machinery and the amount deposited as mentioned in (iv) above, will be deemed to be the cost of new plant and machinery for the purpose of computation of capital gains in the hands of individual or HUF.
- (6) New plant and machinery does not include -
- (i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;
 - (ii) any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;
 - (iii) any office appliances including computers or computer software;
 - (iv) any vehicle; or
 - (v) any machinery or plant, the whole of the actual cost of which is allowed as a deduction, whether by way of depreciation or otherwise, in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.
- (7) Quantum of exemption under section 54GB
- If cost of new plant and machinery \geq Net consideration of residential house, entire capital gains is exempt.
 - If cost of new plant and machinery $<$ Net consideration of residential house, only proportionate capital gains is exempt i.e.
- $$\text{LTCG} \times \frac{\text{Amount invested in new plant and machinery}}{\text{Net consideration}}$$
- (8) The exemption under this section would not be available in respect of transfer of residential property made after 31st March, 2017.
- (9) If the amount deposited by the company as mentioned in point (iv) above, is not utilized wholly or partly for the purchase of new plant and machinery within the period specified, then, the amount of capital gains not charged to tax under section 45 on account of such deposit by the company shall be charged to tax under section 45 as income of the assessee for the previous year in which the period of 1 year from the date of subscription in the equity shares by the assessee expires.

- (10) If the equity shares of the company acquired by the individual or HUF or the new plant and machinery acquired by the company are sold or transferred within a period of five years from the date of acquisition, the amount of capital gains earlier exempt under section 54GB shall be deemed to be the income of the individual or HUF chargeable under the head "Capital Gains" of the previous year in which such equity shares or such new plant and machinery are sold or otherwise transferred. This would be in addition to the capital gains arising on transfer of shares by the individual or HUF or capital gains arising on transfer of new plant and machinery by the company, as the case may be. These are safeguards to restrict the transfer of the shares of the company and of the plant and machinery for a period of 5 years to prevent diversion of these funds.

Illustration 19

Mr. Akash sold his residential property on 2nd February, 2015 for ₹ 90 lakh and paid brokerage@1% of sale price. He had purchased the said property in May 2000 for ₹ 24,36,000. In June, 2015, he invested ₹ 75 lakh in equity of A (P) Ltd., a newly incorporated SME manufacturing company, which constituted 63% of share capital of the said company. A (P) Ltd. utilized the said sum for the following purposes –

- (a) Purchase of new plant and machinery during July 2014 – ₹ 65 lakh
- (b) Included in (a) above are ₹ 6 lakh for purchase of computers and ₹ 8 lakh for purchase of cars.
- (c) Air-conditioners purchased for ₹ 1 lakh, included in the (a) above, were installed at the residence of Mr. Akash.
- (d) Amount deposited in specified bank on 28.9.2015 – ₹ 10 lakh

Compute the chargeable capital gain for the A.Y.2015-16. Assume that Mr. Akash is liable to file his return of income on or before 30th September, 2015 and he files his return on 29.09.2015.

Solution**Computation of taxable capital gains for A.Y.2015-16**

Particulars	₹
Gross consideration	90,00,000
Less: Expenses on transfer (1% of the gross consideration)	<u>90,000</u>
Net consideration	89,10,000
Less: Indexed cost of acquisition (₹ 24,36,000 × 1024/406)	<u>61,44,000</u>
	27,66,000
Less: Exemption under section 54GB (₹ 27,66,000 × ₹ 60,00,000 / ₹ 89,10,000)	<u>18,62,626</u>
Taxable capital gains	<u>9,03,374</u>

Deemed cost of new plant and machinery for exemption under section 54GB			
	Particulars	₹	₹
(1)	Purchase cost of new plant and machinery acquired in July, 2015		65,00,000
	Less: Cost of office appliances, i.e., computers	6,00,000	
	Cost of vehicles, i.e., cars	8,00,000	
	Cost of air-conditioners installed at the residence of Mr. Akash	<u>1,00,000</u>	<u>15,00,000</u>
			50,00,000
(2)	Amount deposited in the specified bank before the due date of filing of return		<u>10,00,000</u>
	Deemed cost of new plant and machinery for exemption under section 54GB		<u>60,00,000</u>

(ix) **Capital Gains Account Scheme (CGAS)** - Under sections 54, 54B, 54D, 54F, 54G and 54GA, capital gains is exempt to the extent of investment of such gains / net consideration (in the case of section 54F) in specified assets within the specified time. If such investment is not made before the date of filing of return of income, then the capital gain or net consideration (in case of exemption under section 54F) has to be deposited under the CGAS.

Time limit - Such deposit in CGAS should be made before filing the return of income or on or before the due date of filing the return of income, whichever is earlier. Proof of such deposit should be attached with the return. The deposit can be withdrawn for utilization for the specified purposes in accordance with the scheme.

Consequences if the amount deposited in CGAS is not utilized within the stipulated time of 2 years / 3 years - If the amount deposited is not utilized for the specified purpose within the stipulated period, then the **unutilized amount shall be charged as capital gain** of the previous year in which the specified period expires. In the case of section 54F, proportionate amount will be taxable.

CBDT Circular No.743 dated 6.5.96 clarifies that in the event of death of an individual before the stipulated period, the unutilized amount is not chargeable to tax in the hands of the legal heirs of the deceased individual. Such unutilized amount is not income but is a part of the estate devolving upon them.

(x) **Extension of time for acquiring new asset or depositing or investing amount of Capital Gain [Section 54H]** - In case of compulsory acquisition of the original asset, where the compensation is not received on the date of transfer, the period available for acquiring a new asset or making investment in CGAS under sections 54, 54B, 54D, 54EC and 54F would be considered from the date of receipt of such compensation and not from the date of the transfer.

4.21 Reference to Valuation Officer [Section 55A]

Section 55A provides that the Assessing Officer may refer the valuation of a capital asset to a Valuation Officer in the following circumstances with a view to ascertaining the fair market value of the capital asset for the purposes of capital gains -

- (i) In a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of the opinion that the value so claimed is at variance with its fair market value.

Under this provision, the Assessing Officer can make a reference to the Valuation Officer in cases where the fair market value is taken to be the sale consideration of the asset. With effect from 1st July, 2012, an Assessing Officer can also make a reference to the Valuation Officer in a case where the fair market value of the asset as on 01.04.1981 is taken as the cost of the asset, if he is of the view that there is any variation between the value as on 01.04.1981 claimed by the assessee in accordance with the estimate made by a registered valuer and the fair market value of the asset on that date.

- (ii) If the Assessing Officer is of the opinion that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than 15% of the value of asset as claimed or by more than ₹ 25,000 of the value of the asset as claimed by the assessee.
- (iii) The Assessing Officer is of the opinion that, having regard to the nature of asset and other relevant circumstances, it is necessary to make the reference.

Where any such reference is made as per this section, the provisions of section 16A of the Wealth-tax Act, 1957 shall be applicable in relation to such reference as they apply in relation to a reference made by the Assessing Officer under section 16A of that Act.

4.22 Short term capital gains tax in respect of equity shares/ units of an equity oriented fund [Section 111A]

- (i) This section provides for a concessional rate of tax (i.e. 15%) on the short-term capital gains on transfer of -

- (1) an equity share in a company or
- (2) a unit of an equity oriented fund or
- (3) a unit of a business trust.¹**

- (ii) The conditions for availing the benefit of this concessional rate are -

- (1) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004, being the date on which Chapter VII of the Finance (No. 2) Act, 2004 came into force; and
- (2) such transaction should be chargeable to securities transaction tax under the said Chapter.

¹ Chapter XII-FA of the Income-tax Act, 1961 and the related provisions dealing with the taxation aspects of business trust would be dealt with at the Final level.

(iii) The proviso to this section provides that in the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then the short-term capital gain will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 15%. However, the benefit of availing the basic exemption limit is not available in the case of non-residents.

(iv) Deductions under Chapter VI-A cannot be availed in respect of such short-term capital gains on equity shares of a company or units of an equity oriented mutual fund included in the total income of the assessee.

The expression "equity oriented fund" has the same meaning assigned to it in the explanation to section 10(38) i.e., "Equity oriented fund" means a fund –

(1) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund; and

(2) which has been set up under a scheme of a Mutual Fund specified under clause (23D).

4.23 Tax on long-term capital gains [Section 112]

(i) Where the total income of an assessee includes long-term capital gains, tax is payable by the assessee @20% on such long-term capital gains. The treatment of long-term capital gains in the hands of different types of assessee are as follows -

(1) Resident individual or Hindu undivided family: Income-tax payable at normal rates on total income as reduced by long-term capital gains plus 20% on such long-term capital gains.

However, where the total income as reduced by such long-term capital gains is below the maximum amount which is not chargeable to income-tax then such long-term capital gains shall be reduced by the amount by which the total income as so reduced falls short of the maximum amount which is not chargeable to income-tax and the tax on the balance of such long-term capital gains will be calculated @ 20%.

(2) Domestic Company: Long-term capital gains will be charged @ 20%.

(3) Non-corporate non-resident / foreign company: (i) Long-term capital gains arising from the transfer of a capital asset, being unlisted securities, would be calculated at the rate of 10% on the capital gains in respect of such asset without giving effect to the indexation provision under second proviso to section 48 and currency fluctuation under first proviso to section 48.

(ii) In respect of other long-term capital gains, the applicable rate of tax would be 20%.

(4) Residents (other than those included in (i) above): Long-term capital gains will be charged @20%.

(ii) The proviso to section 112 states that where the tax payable in respect of any income arising from the transfer of *a listed security (other than a unit) or a zero coupon bond*, being a long-term capital asset, exceeds 10% of the amount of capital gains before indexation, then such excess shall be ignored while computing the tax payable by the assessee.

Consequently, long term capital gains on transfer of units of debt oriented mutual fund and unlisted securities are not eligible for concessional rate of tax@10% (without indexation benefit). Therefore, the long-term capital gains, in such cases, is taxable@20% (with indexation benefit).

However, the concessional rate of 10% (without indexation benefit) would be available in respect of long-term capital gains arising on units of debt equity oriented fund transferred during the period from 1st April, 2014 to 10th July, 2014, being the date of introduction of the Finance (No.2) Bill, 2014 in the Lok Sabha.

(iii) For this purpose, "listed securities" means securities as defined by section 2(h) of the Securities Contracts (Regulation) Act, 1956.

(iv) The provisions of section 112 make it clear that the deductions under Chapter VIA cannot be availed in respect of the long-term capital gains included in the total income of the assessee.

4.24 Exemption of long term capital gains on sale of equity shares/ Units of an equity oriented fund [Section 10(38)]

(i) Section 10(38) exempts long term capital gains on transfer of equity shares of a company or units of an equity oriented fund or ***units of a business trust***.

(ii) This exemption is available only if such transaction is chargeable to securities transaction tax.

(iii) However, such long term capital gains exempt under section 10(38) shall be taken into account in computing the book profit and income tax payable under section 115JB.

(iv) For the purpose of this clause, "Equity oriented fund" means a fund –

(1) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund; and

(2) which has been set up under a scheme of Mutual Fund specified under clause (23D).

(v) The percentage of equity share holding of the fund should be computed with reference to the annual average of the monthly averages of the opening and closing figures.

UNIT – 5 : INCOME FROM OTHER SOURCES

Learning Objectives

After studying this unit, you would be able to understand -

- ◆ which are the income chargeable under the head “Income from other sources”
- ◆ what are meant by bond washing transactions and dividend stripping
- ◆ what is the rate of tax applicable on casual income
- ◆ what are the admissible deductions while computing income under this head
- ◆ what are the inadmissible deductions while computing income under this head
- ◆ what is the relevance of method of accounting while computing the income under this head.

5.1 Introduction

Any income, profits or gains includible in the total income of an assessee, which cannot be included under any of the preceding heads of income, is chargeable under the head ‘Income from other sources’. Thus, this head is the residuary head of income and brings within its scope all the taxable income, profits or gains of an assessee which fall outside the scope of any other head. Therefore, when any income, profit or gain does not fall precisely under any of the other specific heads but is chargeable under the provisions of the Act, it would be charged under this head.

5.2 Incomes chargeable under this head [Section 56]

(i) The following income shall be chargeable only under the head ‘Income from other sources’:

- (1) Dividend income [covered by sections 2(22)(a) to (e)].
- (2) Casual income in the nature of winning from lotteries, crossword puzzles, horse races, card games and other games of any sort, gambling, betting etc. Such winnings are chargeable to tax at a flat rate of 30% under section 115BB.
- (3) **Any sum of money or value of property received without consideration or value of property, other than immovable property, received for inadequate consideration to be subject to tax in the hands of the recipient, being an individual or HUF [Section 56(2)(vii)]**
 - (i) Section 56(2)(vii) brings to tax any sum of money or the value of any property received by an individual or HUF without consideration or the value of any property, other than immovable property, received for inadequate consideration. For this purpose, “property” means immovable property being land or building or both, shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art or bullion.
 - (ii) If an immovable property is received without consideration, the stamp duty value of such property would be taxed as the income of the recipient if it exceeds ₹ 50,000.

- (iii) In order to prevent tax avoidance by transferring immovable property at prices significantly lower than the circle rates, section 56(2)(vii) provides that where any immovable property is received for a consideration which is less than the stamp duty value of the property by an amount exceeding ₹ 50,000, the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the individual or HUF as "Income from other sources".
- (iv) Taking into consideration the possible time gap between the date of agreement and the date of registration, the stamp duty value may be taken as on the date of agreement instead of the date of registration, if the date of the agreement fixing the amount of consideration for the transfer of the immovable property and the date of registration are not the same, provided at least a part of the consideration has been paid by any mode other than cash on or before the date of agreement.
- (v) If the stamp duty value of immovable property is disputed by the assessee, the Assessing Officer may refer the valuation of such property to a Valuation Officer. In such a case, the provisions of section 50C and section 155(15) shall, as far as may be, apply for determining the value of such property.
- (vi) If movable property is received without consideration, the aggregate fair market value of such property on the date of receipt would be taxed as the income of the recipient, if it exceeds ₹ 50,000. In case movable property is received for inadequate consideration, and the difference between the aggregate fair market value and such consideration exceeds ₹ 50,000, such difference would be taxed as the income of the recipient. The CBDT would prescribe the method of determination of fair market value of a movable property.
- (vii) The provisions of section 56(2)(vii) would apply only to property which is the nature of a capital asset of the recipient and not stock-in-trade, raw material or consumable stores of any business of the recipient. Therefore, only transfer of a capital asset, without consideration and transfer of a capital asset, other than immovable property, for inadequate consideration would attract the provisions of section 56(2)(vii).
- (viii) The table below summarises the scheme of taxability of gifts –

	Nature of asset	Particulars	Taxable value
1	Money	Without consideration	The whole amount if the same exceeds ₹ 50,000.

2	Movable property	Without consideration	The aggregate fair market value of the property, if it exceeds ₹ 50,000.
3	Movable property	Inadequate consideration	The difference between the aggregate fair market value and the consideration, if such difference exceeds ₹ 50,000.
4	Immovable property	Without consideration	The stamp value of the property, if it exceeds ₹ 50,000.
5	Immovable property	Inadequate consideration	The difference between the stamp duty value and the consideration, if such difference exceeds ₹ 50,000.

- (ix) However, any sum of money or value of property received -
- from any relative; or
 - on the occasion of the marriage of the individual; or
 - under a will or by way of inheritance; or
 - in contemplation of death of the payer or donor, as the case may be; or
 - from any local authority as defined in the Explanation to section 10(20); or
 - from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in section 10(23C); or
 - from any trust or institution registered under section 12AA
- would be outside the ambit of section 56(2)(vii).
- (x) The term "relative" for the purpose of section 56(2)(vii) would mean -
- in case of an individual -
 - spouse of the individual;
 - brother or sister of the individual;
 - brother or sister of the spouse of the individual;
 - brother or sister of either of the parents of the individual;
 - any lineal ascendant or descendant of the individual;
 - any lineal ascendant or descendant of the spouse of the individual;
 - spouse of any of the persons referred to above.
 - In case of Hindu Undivided Family, any member thereof.

Illustration 1

Mr. A, a dealer in shares, received the following without consideration during the P.Y.2014-15 from his friend Mr. B, -

- (1) Cash gift of ₹ 75,000 on his anniversary, 15th April, 2014.
- (2) Bullion, the fair market value of which was ₹ 60,000, on his birthday, 19th June, 2014.
- (3) A plot of land at Faridabad on 1st July, 2014, the stamp value of which is ₹ 5 lakh on that date. Mr. B had purchased the land in April, 2008.

Mr. A purchased from his friend Mr. C, who is also a dealer in shares, 1000 shares of X Ltd. @ ₹ 400 each on 19th June, 2014, the fair market value of which was ₹ 600 each on that date. Mr. A sold these shares in the course of his business on 23rd June, 2014.

Further, on 1st November, 2014, Mr. A took possession of property (building) booked by him two years back at ₹ 20 lakh. The stamp duty value of the property as on 1st November, 2014 was ₹ 32 lakh and on the date of booking was ₹ 23 lakh. He had paid ₹ 1 lakh by cheque as down payment on the date of booking.

On 1st March, 2015, he sold the plot of land at Faridabad for ₹ 7 lakh.

Compute the income of Mr. A chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2015-16.

Solution**Computation of "Income from other sources" of Mr. A for the A.Y.2015-16**

	Particulars	₹
(1)	Cash gift is taxable under section 56(2)(vii), since it exceeds ₹ 50,000	75,000
(2)	Since bullion is included in the definition of property, therefore, when bullion is received without consideration, the same is taxable, since the aggregate fair market value exceeds ₹ 50,000	60,000
(3)	Stamp value of plot of land at Faridabad, received without consideration, is taxable under section 56(2)(vii)	5,00,000
(4)	Difference of ₹ 2 lakh in the value of shares of X Ltd. purchased from Mr. C, a dealer in shares, is not taxable as it represents the stock-in-trade of Mr. A. Since Mr. A is a dealer in shares and it has been mentioned that the shares were subsequently sold in the course of his business, such shares represent the stock-in-trade of Mr. A.	-
(5)	Difference between the stamp duty value of ₹ 23 lakh on the date of booking and the actual consideration of ₹ 20 lakh paid is taxable under section 56(2)(vii).	3,00,000
Income from Other Sources		9,35,000

Computation of "Capital Gains" of Mr. A for the A.Y.2015-16

Particulars	₹
Sale Consideration	7,00,000
Less: Cost of acquisition [deemed to be the stamp value charged to tax under section 56(2)(vii) as per section 49(4)]	5,00,000
Short-term capital gains	2,00,000

Note – The resultant capital gains will be short-term capital gains since for calculating the period of holding, the period of holding of previous owner is not to be considered.

Illustration 2

Discuss the taxability or otherwise of the following in the hands of the recipient under section 56(2)(vii) the Income-tax Act, 1961 -

- Akhil HUF received ₹ 75,000 in cash from niece of Akhil (i.e., daughter of Akhil's sister). Akhil is the Karta of the HUF.
- Nitisha, a member of her father's HUF, transferred a house property to the HUF without consideration. The stamp duty value of the house property is ₹ 9,00,000.
- Mr. Akshat received 100 shares of A Ltd. from his friend as a gift on occasion of his 25th marriage anniversary. The fair market value on that date was ₹ 100 per share. He also received jewellery worth ₹ 45,000 (FMV) from his nephew on the same day.
- Kishan HUF gifted a car to son of Karta for achieving good marks in XII board examination. The fair market value of the car is ₹ 5,25,000.

Solution

	Taxable/ Non- taxable	Amount liable to tax (₹)	Reason
(i)	Taxable	75,000	Sum of money exceeding ₹ 50,000 received without consideration from a non-relative is taxable under section 56(2)(vii). Daughter of Mr. Akhil's sister is not a relative of Akhil HUF, since she is not a member of Akhil HUF.
(ii)	Non- taxable	Nil	Immovable property received without consideration by a HUF from its relative is not taxable under section 56(2)(vii). Since Nitisha is a member of the HUF, she is a relative of the HUF. However, income from such asset would be included in the hands of Nitisha under 64(2).
(iii)	Taxable	55,000	As per provisions of section 56(2)(vii), in case the aggregate fair market value of property, other than immovable property, received without consideration exceeds ₹ 50,000, the whole of

			the aggregate value shall be taxable. In this case, the aggregate fair market value of shares (₹ 10,000) and jewellery (₹ 45,000) exceeds ₹ 50,000. Hence, the entire amount of ₹ 55,000 shall be taxable.
(iv)	Non-taxable	Nil	Car is not included in the definition of property for the purpose of section 56(2)(vii), therefore, the same shall not be taxable.

Illustration 3

Mr. Hari, a property dealer, sold a building in the course of his business to his friend Rajesh, who is a dealer in automobile spare parts, for ₹ 90 lakh on 1.1.2015, when the stamp duty value was ₹ 150 lakh. The agreement was, however, entered into on 1.7.2014 when the stamp duty value was ₹ 140 lakh. Mr. Hari had received a down payment of ₹ 15 lakh by cheque from Rajesh on the date of agreement. Discuss the tax implications in the hands of Hari and Rajesh, assuming that Mr. Hari has purchased the building for ₹ 75 lakh on 12th July, 2013.

Would your answer be different if Hari was a share broker instead of a property dealer?

Solution**Case 1: Tax implications if Mr. Hari is a property dealer**

In the hands of Mr. Hari	In the hands of Mr. Rajesh
In the hands of Hari, the provisions of section 43CA would be attracted, since the building represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value on the date of agreement. Therefore, ₹ 65 lakh , being the difference between the stamp duty value on the date of agreement (i.e., ₹ 140 lakh) and the purchase price (i.e., ₹ 75 lakh), would be chargeable as business income in the hands of Mr. Hari.	Since Mr. Rajesh is a dealer in automobile spare parts, the building purchased would be a capital asset in his hands. The provisions of section 56(2)(vii) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration. Therefore, ₹ 50 lakh , being the difference between the stamp duty value of the property (i.e., ₹ 140 lakh) and the actual consideration (i.e., ₹ 90 lakh) would be taxable under section 56(2)(vii) in the hands of Mr. Rajesh .

Case 2: Tax implications if Mr. Hari is a stock broker

In the hands of Mr. Hari	In the hands of Mr. Rajesh
<p>In case Mr. Hari is a stock broker and not a property dealer, the building would represent his capital asset and not stock-in-trade. In such a case, the provisions of section 50C would be attracted in the hands of Mr. Hari and ₹ 75 lakh, being the difference between the stamp duty value on the date of registration (i.e., ₹ 150 lakh) and the purchase price (i.e., ₹ 75 lakh) would be chargeable as short-term capital gains.</p> <p>It may be noted that under section 50C, there is no option to adopt the stamp duty value on the date of agreement, even if the date of agreement is different from the date of registration and part of the consideration has been received on or before the date of agreement otherwise than by way of cash.</p>	<p>There would be no difference in the taxability in the hands of Mr. Rajesh, whether Mr. Hari is a property dealer or a stock broker.</p> <p>Therefore, the provisions of section 56(2)(vii) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration. Therefore, ₹ 50 lakh, being the difference between the stamp duty value of the property (i.e., ₹ 140 lakh) and the actual consideration (i.e., ₹ 90 lakh) would be taxable under section 56(2)(vii) in the hands of Mr. Rajesh.</p>

(4) Transfer of shares without consideration or for inadequate consideration to attract the provisions of section 56(2) in case of recipient firms and companies also [Section 56(2)(viiia)]

- (i) Section 56(2)(viiia) provides that the transfer of shares of a company without consideration or for inadequate consideration would attract the provisions of section 56(2), if the recipient is a firm or a company. The purpose is to prevent the practice of transferring unlisted shares at prices much below their fair market value.
- (ii) If such shares are received without consideration, the aggregate fair market value on the date of transfer would be taxed as the income of the recipient firm or company, if it exceeds ₹ 50,000. If such shares are received for inadequate consideration, the difference between the aggregate fair market value and the consideration would be taxed as the income of the recipient firm or company, if such difference exceeds ₹ 50,000.
- (iii) However, the provisions of section 56(2)(viiia) would not apply in the case of transfer of shares -
 - (1) of a company in which the public are substantially interested; or
 - (2) to a company in which the public are substantially interested.
- (iv) Certain transactions are exempted from the application of the provisions of this clause, namely, transactions covered under the following sections:

Section	Transaction
47(via)	Transfer of shares held in an Indian company, in a scheme of amalgamation, by the amalgamating foreign company to an amalgamated foreign company.
47(vic)	Transfer of shares held in an Indian company, in a scheme of demerger, by the demerged foreign company to a resulting foreign company.
47(vicb)	Transfer by a shareholder, in a business reorganization, of shares held in the predecessor co-operative bank, in consideration of the allotment of shares in the successor co-operative bank.
47(vid)	Transfer or issue of shares by the resulting company, in a scheme of demerger, to the shareholders of the demerged company in consideration of demerger of the undertaking.
47(vii)	Transfer by a shareholder, in a scheme of amalgamation, of shares in the amalgamating company in consideration of allotment to him of shares in the amalgamated Indian company.

(5) Consideration received in excess of FMV of shares issued by a closely held company to be treated as income of such company, where shares are issued at a premium [Section 56(2)(viib)]

- (i) Section 56(2)(viib) brings to tax the consideration received from a resident person by a company, other than a company in which public are substantially interested, which is in excess of the fair market value (FMV) of shares.
- (ii) Such excess is to be treated as the income of a closely held company taxable under section 56(2) under the head "Income from Other Sources", in cases where consideration received for issue of shares exceeds the face value of shares i.e. where shares are issued at a premium.
- (iii) However, these provisions would not be attracted where consideration for issue of shares is received:
 - (1) by a Venture Capital Undertaking (VCU) from a Venture Capital Fund (VCF) or Venture Capital Company (VCC); or
 - (2) by a company from a class or classes of persons as notified by the Central Government for this purpose.
- (iv) Fair market value of the shares shall be the higher of, the value as may be –
 - (a) determined in accordance with the prescribed method; or
 - (b) substantiated by the company to the satisfaction of the Assessing Officer, based on the value of its assets on the date of issue of shares.

For the purpose of computation of FMV, the value of assets would include the value of intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

Illustration 4

The following are the details of the shares issued by the following closely held companies. Discuss the applicability of provisions of section 56(2)(viib) in the hands of these companies:

Co.	No. of shares	Face value of shares (₹)	FMV of shares (₹)	Issue price of shares (₹)	Applicability of section 56(2)(viib)
A (P) Ltd.	10,000	100	120	130	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium (i.e., issue price exceeds the face value of shares). The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib). ₹ 1,00,000 $[10,000 \times ₹ 10 (₹ 130 - ₹ 120)]$ shall be treated as income in the hands of A (P) Ltd.
B (P) Ltd.	20,000	100	120	110	The provisions of section 56(2)(viib) are attracted since the shares are issued at a premium. However, no sum shall be chargeable to tax in the hands of B (P) Ltd. under the said section as the shares are issued at a price less than the FMV of shares.
C (P) Ltd.	30,000	100	90	98	Section 56(2)(viib) is not attracted since the shares are issued at a discount, though the issue price is greater than the FMV.
D (P) Ltd.	40,000	100	90	110	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium. The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib). Therefore, ₹ 8,00,000 $[40,000 \times ₹ 20 (₹ 110 - ₹ 90)]$ shall be treated as income in the hands of D (P) Ltd.

- (6) Interest received on compensation/enhanced compensation deemed to be income in the year of receipt and taxable under the head "Income from Other Sources" [Sections 56(2)(viii)]

(i) As per section 145(1), income chargeable under the head "Profits and gains of business or profession" or "Income from other sources", shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee.

(ii) Further, the Hon'ble Supreme Court has, in *Rama Bai v. CIT (1990) 181 ITR 400*, held that arrears of interest computed on delayed or on enhanced compensation shall be taxable on accrual basis. The tax payers are facing genuine difficulty on account of this ruling, since the interest would have accrued over a number of years, and consequently the income of all the years would undergo a change.

(iii) Therefore, to remove this difficulty, clause (b) of section 145A provides that the interest received by an assessee on compensation or on enhanced compensation shall be deemed to be his income for the year in which it is received, irrespective of the method of accounting followed by the assessee.

(iv) Section 56(2)(viii) provides that income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A shall be assessed as "Income from other sources" in the year in which it is received.

(7) **Advance forfeited due to failure of negotiations for transfer of a capital asset to be taxable as "Income from other sources" [Section 56(2)(ix)]**

(i) *Any advance retained or received in respect of a negotiation for transfer which failed to materialise is reduced from the cost of acquisition of the asset or the written down value or the fair market value of the asset, at the time of its transfer to compute the capital gains arising therefrom as per section 51. In case the asset transferred is a long-term capital asset, indexation benefit would be on the cost so reduced.*

(ii) *With effect from A.Y.2015-16, new clause (ix) has been inserted in section 56(2) to provide for the taxability of any sum of money, received as an advance or otherwise in the course of negotiations for transfer of a capital asset. Such sum shall be chargeable to income-tax under the head 'Income from other sources', if such sum is forfeited and the negotiations do not result in transfer of such capital asset.*

(iii) *In order to avoid double taxation of the advance received and retained, section 51 has been amended to provide that where any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, has been included in the total income of the assessee for any previous year, in accordance with section 56(2)(ix), such amount shall not be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.*

(iv) *It may be noted that advance received and forfeited upto 31.3.2014 has to be reduced from cost of acquisition while computing capital gains, since such advance would not have been subject to tax under section 56(2)(ix). Only the advance received and forfeited on or after 1.4.2014 would be subject to tax under section 56(2)(ix). Hence, such advance would not be reduced from the cost of acquisition for computing capital gains.*

(ii) The following income are chargeable under the head "Income from other sources" only if such income are not chargeable under the head "Profits and gains of business or profession" -

- (1) Any sum received by an employer-assessee from his employees as contributions to any provident fund, superannuation fund or any other fund for the welfare of the employees
- (2) Interest on securities
- (3) Income from letting out on hire, machinery, plant or furniture.
- (4) Where letting out of buildings is inseparable from the letting out of machinery, plant or furniture, the income from such letting.

(iii) Any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy is chargeable under the head "Income from other sources" if such income is not chargeable under the head "Profits and gains of business or profession" or under the head "Salaries" i.e. if such sum is received by any person other than the employer who took the policy and the employee in whose name the policy was taken.

(iv) Any income chargeable to tax under the Act, but not falling under any other head of income shall be chargeable to tax under the head "Income from other sources" e.g. Salary received by an MPs/MLAs will not be chargeable to income-tax under the head 'Salary' but will be chargeable as "Income from other sources" under section 56.

5.3 Bond washing transactions and dividend stripping [Section 94]

(i) A bond-washing transaction is a transaction where securities are sold some time before the due date of interest and reacquired after the due date is over. This practice is adopted by persons in the higher income group to avoid tax by transferring the securities to their relatives/friends in the lower income group just before the due date of payment of interest. In such a case, interest would be taxable in the hands of the transferee, who is the legal owner of securities. In order to discourage such practice, section 94(1) provides that where the owner of a security transfers the security just before the due date of interest and buys back the same immediately after the due date and interest is received by the transferee, such interest income will be deemed to be the income of the transferor and would be taxable in his hands.

(ii) In order to prevent the practice of sale of securities-cum-interest, section 94(2) provides that if an assessee who has beneficial interest in securities sells such securities in such a manner that either no income is received or income received is less than the sum he would have received if such interest had accrued from day to day, then income from such securities for the whole year would be deemed to be the income of the assessee.

(iii) Section 94(7) provides that where

- (a) any person buys or acquires any securities or unit within a period of three months prior to the record date and
- (a) such person sells or transfers –

- (1) such securities within a period of three months after such date, or
- (2) such unit within a period of nine months after such date and
- (c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then, the loss, if any, arising therefrom shall be ignored for the purposes of computing his income chargeable to tax. Such loss should not exceed the amount of dividend or income received or receivable on such securities or unit.

5.4 Applicable rate of tax in respect of casual income [Section 115BB]

- (i) This section provides that income by way of winnings from lotteries, crossword puzzles, races including horse races or card games and other games of any sort or from gambling or betting of any form would be taxed at a flat rate of 30% plus surcharge, if applicable, plus education cess plus secondary and higher education cess.
- (ii) No expenditure or allowance can be allowed from such income.
- (iii) Deduction under Chapter VI-A is not allowable from such income.
- (iv) Adjustment of unexhausted basic exemption limit is also not permitted against such income.

5.5 Deductions allowable [Section 57]

The income chargeable under the head "Income from other sources" shall be computed after making the following deductions:

- (i) In the case of dividends (other than dividends referred to in section 115-O) or interest on securities, any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such dividend or interest on behalf of the assessee.
- (ii) Where the income consists of recovery from employees as contribution to any provident fund etc. in terms of clause (x) of section 2(24), then, a deduction will be allowed in accordance with the provisions of section 36(1)(va) i.e. to the extent the contribution is remitted before the due date under the respective Acts.
- (iii) Where the income to be charged under this head is from letting on hire of machinery, plant and furniture, with or without building, the following items of deductions are allowable in the computation of such income:
 - (a) the amount paid on account of any current repairs to the machinery, plant or furniture.
 - (b) the amount of any premium paid in respect of insurance against risk of damage or destruction of the machinery or plant or furniture.
 - (c) the normal depreciation allowance in respect of the machinery, plant or furniture, due thereon.
 - (iv) In the case of income in the nature of family pension, a deduction of a sum equal to $33\frac{1}{3}$ per cent of such income or ₹ 15,000, whichever is less, is allowable. For the purposes of this deduction "family pension" means a regular monthly amount payable by the employer to a person belonging to the family of an employee in the event of his death.

(v) Any other expenditure not being in the nature of capital expenditure laid out or expended wholly and exclusively for the purpose of making or earning such income.

(vi) 50% of income by way of compensation/enhanced compensation received chargeable to tax under section 56(2)(viii). No deduction would be allowable under any other clause of section 57 in respect of such income.

Illustration 5

Interest on enhanced compensation received by Mr.G during the previous year 2014-15 is ₹ 5,00,000. Out of this interest, ₹ 1,50,000 relates to the previous year 2010-11, ₹ 1,65,000 relates to previous year 2011-12 and ₹ 1,85,000 relates to previous year 2012-13. Discuss the tax implication, if any, of such interest income for A.Y.2015-16.

Solution

The entire interest of ₹ 5,00,000 would be taxable in the year of receipt, namely, P.Y.2014-15.

Particulars	₹
Interest on enhanced compensation taxable u/s 56(2)(viii)	5,00,000
Less: Deduction under section 57(iv) @50%	2,50,000
Interest chargeable under the head "Income from other sources"	2,50,000

Note - The Supreme Court held in *CIT v. Rajindra Prasad Moody* [1978] 115 ITR 519, that in order to claim deduction under section 57 in respect of any expenditure, it is not necessary that income should in fact have been earned as a result of the expenditure. In this view of the matter, the Court held that the interest on money borrowed for investment in shares which had not yielded any taxable dividend was admissible as a deduction under section 57 under the head, "Income from other sources".

5.6 Deductions not allowable [Section 58]

No deduction shall be made in computing the "Income from other sources" of an assessee in respect of the following items of expenses:

- (i) In the case of any assessee:
 - (1) any personal expense of the assessee;
 - (2) any interest chargeable to tax under the Act which is payable outside India on which tax has not been paid or deducted at source.
 - (3) any payment taxable in India as salaries, if it is payable outside India unless tax has been paid thereon or deducted at source.
- (ii) In addition to these disallowances, section 58(2) specifically provides that the disallowance of payments to relatives and associate concerns and disallowance of payment or aggregate of payments exceeding ₹ 20,000 made to a person during a day otherwise than by account payee cheque or draft covered by section 40A will be applicable to the computation of income under the head 'Income from other sources' as well.

(iii) Income-tax and wealth-tax paid.

(iv) No deduction in respect of any expenditure or allowance in connection with income by way of earnings from lotteries, cross word puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever shall be allowed in computing the said income.

The prohibition will not, however, apply in respect of the income of an assessee, being the owner of race horses, from the activity of owning and maintaining such horses. In respect of the activity of owning and maintaining race horses, expenses incurred shall be allowed even in the absence of any stake money earned. Such loss shall be allowed to be carried forward in accordance with the provisions of section 74A.

5.7 Deemed income chargeable to tax [Section 59]

The provisions of section 41(1) are made applicable, so far as may be, to the computation of income under this head. Accordingly, where a deduction has been made in respect of a loss, expenditure or liability and subsequently any amount is received or benefit is derived in respect of such expenditure incurred or loss or trading liability allowed as deduction, then it shall be deemed as income in the year in which the amount is received or the benefit is accrued.

5.8 Method of accounting [Section 145]

Income chargeable under the head "Income from other sources" has to be computed in accordance with the cash or mercantile system of accounting regularly employed by the assessee. However, deemed dividend under section 2(22)(e) is chargeable to tax on payment basis under section 8, irrespective of the method of accounting followed by the assessee.